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Office of the Chairman
Administrative Conference of the United States

# Administrative Conference of the United States

## Recommendations and Reports

1991

Indexed Bibliography
1968-1991

# Administrative Conference of the United States

The Administrative Conference of the United States was established by statute as an independent agency of the federal government in 1964. Its purpose is to promote improvements in the efficiency, adequacy, and fairness of procedures by which federal agencies conduct regulatory programs, administer grants and benefits, and perform related governmental functions.

To this end, the Conference conducts research and issues reports concerning various aspects of the administrative process and, when warranted, makes recommendations to the President, Congress, particular departments and agencies, and the judiciary concerning the need for procedural reforms. Implementation of Conference recommendations may be accomplished by direct action on the part of the affected agencies or through legislative changes.

Office of the Chairman
Administrative Conference of the United States

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## Recommendations and Reports

1991

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# Recommendation 91-1

## Federal Agency Cooperation with Foreign Government Regulators

If American administrative agencies could ever afford to engage in regulatory activities without regard to the policies and practices of administrative agencies abroad, the character and pace of world developments suggest that that era has come to a close. The substantive problems facing agencies have parallels, to a greater or lesser extent, in the problems facing those agencies' counterparts in foreign countries. The policies and procedures developed by governments abroad are likely to be of interest and benefit to American regulators, and those developed here may be of utility abroad.

The case for international regulatory cooperation does not, however, rest entirely on the exchange of information about the current regulatory landscape. As the experience of certain agencies engaged in international regulatory dialogue demonstrates, there still remain regulatory problems to be identified and solutions, both to new and existing problems, to be found. Particularly in areas of fast-changing technology or fast-evolving standards and expectations, regulatory bodies may find that they actually need, or can profitably share, the resources of other governments in addressing common problems of regulation and enforcement. In their continuous efforts at improving their performance, agencies have become increasingly aware that contemporary regulation often entails a powerful research and development burden whose sharing may be in all regulators' best interests.

Regulatory cooperation with foreign counterparts will also produce advantages for regulated interests and for those affected by those interests. Regulated entities generally prefer an orderly regulatory environment, and more particularly one marked by a high degree of commonality among the standards imposed by public authorities in the various markets they serve. Costs of compliance are most obvious when different countries impose mutually inconsistent standards on business products or practices, particularly where the latter by their nature are international in scope. However, even where national standards are not mutually inconsistent, or business products or practices are not inherently international in scope, the cumulative effect of differences in regulatory standards may impose substantial and, in some cases, unjustified burdens. In addition, consumers and other affected persons have an interest in the maintenance of reasonably common protective standards. The internationalization of business has put the need for this kind of environment on an international scale. It accordingly points in the direction of greater and more deliberate intergovernmentalism in regulatory matters than one generally associates with American administrative processes.

American agencies generally have not developed consistent practices in their efforts at international regulatory cooperation. Such cooperation may, in fact, take a wide variety of forms, from the casual and unsystematic sharing of information at one extreme, to a firm commitment to concerted regulatory action at the other. In between fall a number of different patterns, such as regular consultations, reciprocal participation in foreign agency rulemaking, and various forms of joint study, research and rule development. Since harmonization does not necessarily entail uniformity, but simply a net reduction in regulatory inconsistencies and differences, even harmonization is a matter of degree.

As the following recommendation seeks to make clear, agencies are not all similarly situated with respect to the opportunities for, and advantages of, regulatory cooperation. The functions and regulatory objectives of a particular agency, its past experience in such cooperation, and the feasibility of reliance on a foreign counterpart's technical, administrative, or regulatory resources are among the factors determining whether, to what extent, and in what form that agency should engage in such cooperation and pursue regulatory harmonization. Moreover, an agency is likely to be more comfortable in initially experimenting with international cooperation on a limited basis by selected means rather than in developing at once a comprehensive, systematic program of cooperation. Nevertheless, agencies may usefully consider this recommendation, which is based in part on the practice and experience of one agency, the Federal Aviation Administration, that has consciously engaged in forms of concerted activity with counterpart agencies abroad. This case study is of particular interest because the FAA's practice of intergovernmentalism includes, but also goes beyond, cooperation in rulemaking as such to include a certain amount of cooperation in more routine aspects of administration. While this recommendation does not address international assistance in enforcement as such, it recognizes that an increased commonality of substantive standards does tend to increase opportunities for mutual assistance in the enforcement realm.

Of course, care should be taken that the spirit of compromise and mutual consideration that ought to characterize intergovernmental activities not adversely affect the integrity of the regulatory process. It is important that agencies observe the procedural statutes under which they ordinarily operate, and that their processes remain open to public scrutiny and participation. Nor will it do, either in reality or in appearance, for the regulatory standards an agency ultimately adopts to be the product, pure and simple, of intergovernmental negotiations. American agencies and their foreign counterparts work under statutory mandates, which must remain the touchstone so far as the substance of regulatory action is concerned. The zone of compromise within which an agency may then operate in the interest of collegiality with decisionmakers of other nations is necessarily uncertain but necessarily limited. Within that zone, however, international regulatory cooperation has a significant, possibly even a leading, role to play.

## RECOMMENDATION

1. Each agency should inform itself of the existence of foreign (including regional and international) regulatory bodies[1] whose activities may relate to the mission of that agency.

2. Each agency should determine whether and to what extent regulatory cooperation with one or more foreign regulatory bodies is appropriate. Desirable forms of cooperation may include the simple exchange of information, coordination of regulatory objectives, consultation in advance of rulemaking, and reciprocal participation in rulemaking processes. Apart from general considerations of cost and staffing, factors to be considered in deciding the importance and intensity of the cooperative effort to be made, the forms of cooperation to adopt, and the geographic range of foreign regulatory bodies with which to cooperate, include:

   a. the extent to which the participating regulatory agencies share common regulatory objectives;

   b. the importance of commonality, and therefore international harmonization,[2] in the development of regulatory policy in the particular field;

   c. the extent to which the capabilities of foreign regulatory bodies justify the agency's reliance on their technical, regulatory and administrative resources;

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[1] Throughout this recommendation, the term "foreign regulatory bodies" includes, where appropriate, also regional and international regulatory bodies.

[2] Harmonization does not necessarily imply regulatory uniformity. It implies a reduction in the differences (including but not limited to inconsistencies) among the regulatory standards of different jurisdictions.

d. the opportunities that international regulatory cooperation presents for improvement in the enforcement and administration of the agency's program (as, for example, through mutual recognition of tests, inspections and certifications or through mutual assistance in information gathering and other forms of assistance);

e. the presence of existing bilateral or multilateral international frameworks for addressing common regulatory concerns;

f. the receptivity of a given foreign regulatory body to meaningful participation by American regulatory and private interests in its policymaking processes; and

g. in appropriate consultation with the Department of State, the foreign policy of the United States.

3. Even when an agency concludes that the factors set out in paragraph 2 do not counsel substantial regulatory cooperation with foreign governments, it should nevertheless explore the possibilities of international cooperation in enforcement, including mutual assistance in information gathering and, where appropriate, reliance upon foreign tests, inspections, and certifications.

4. When an agency concludes that it has a pronounced interest in cooperation with foreign regulatory bodies, it should consider adopting various modes of cooperation with those agencies, including:

a. the establishment of common regulatory agendas;

b. the systematic exchange of information about present and proposed foreign regulation;

c. concerted efforts to reduce differences between the agency's rules and those adopted by foreign government regulators where those differences are not justified;

d. the creation of joint technical or working groups to conduct joint research and development and to identify common solutions to regulatory problems (for example, through parallel notices of proposed rulemaking);

e. the establishment of joint administrative teams to draft common procedures and enforcement policies;

f. the mutual recognition of foreign agency tests, inspections and certifications, to the extent that the American agency is satisfied that foreign regulatory bodies have sufficient expertise and employ comparable standards; and

g. the holding of periodic bilateral or multilateral meetings to assess the effectiveness of past cooperative efforts and to chart future ones.

5.

a. When engaging in international regulatory cooperation, an agency should ensure that it does so in a manner consistent with national statutes and international engagements.

b. An agency engaging in international regulatory cooperation should also be alert to the possibility that foreign regulatory bodies may have different regulatory objectives, particularly where a government-owned or controlled enterprise is involved.

6. To promote acceptance of and compliance with the measures that result from its cooperation with foreign regulatory bodies, an agency should enlist the support and participation of other affected agencies, regulated interests, public interest groups, and other affected domestic interests, as follows:

a. Where appropriate, agencies should, so far as considerations of time and international relations permit, afford affected private and public interests timely notice of any formal system of collaboration with foreign regulatory bodies that exists and an opportunity where reasonable to participate and comment on decisionmaking under such system.

b. The agency should, where appropriate, also encourage the establishment of working relations between domestic interests and their foreign counterparts, including manufacturers, other trade and industry interests, and consumer and other public interest groups.

c. The agency should assemble an interagency advisory group, consisting of the Department of State and other affected agencies such as the Departments of Commerce and Defense and the U.S. Trade Representative's Office, if one does not exist. Each member agency of an advisory group should, without prejudice to its independent decisionmaking, both inform that group about the nature and extent of its concerted activities with foreign regulatory bodies relevant to the purposes of the group and seek that group's advice. In addition, the Chairman of the Administrative Conference should convene a meeting of the heads of interested agencies to discuss the need for establishing a permanent, government-wide mechanism for organizing, promoting, and monitoring international regulatory cooperation on the part of American agencies.

7. Agencies should, consistent with their statutory mandate and the public interest, give sympathetic consideration to petitions by private and public interest groups for proposed rulemaking that contemplate the reduction of

differences between agency rules and the rules adopted by foreign government regulators, where those differences are not justified.

8.

a. Once an agency has a program of international regulatory cooperation with a foreign regulatory body, it should routinely advise that body before initiating proposed rulemaking, and should seek to engage that body's participation in the rulemaking process.

b. Conversely, the agency should see to it that it is informed of initiatives by those foreign regulatory bodies and ensure that its views are considered by those bodies early in the conduct of their rulemaking procedures.

c. Where, following joint rule development efforts, an agency ultimately proposes a rule that differs from the rule proposed by the foreign counterpart, it should specify the difference in its notice of proposed rulemaking and request that it be specified in any corresponding foreign notice.

9. An agency should adopt reasonable measures to facilitate communication of views by foreign regulatory bodies on proposed rules.

10. While international consultations of the sort described in this recommendation do not appear to necessitate any radical departure from an agency's ordinary practices in compliance with applicable procedural statutes,[3] an agency engaged in such consultations should make reasonable efforts to ensure that affected interests are aware of them. For example, when an agency substantially relies on those consultations in its rulemaking (or where foreign government rules, practices or views have otherwise substantially influenced the agency's proposals), it should describe both the fact and the substance of those consultations in its notices of proposed rulemaking, rulemaking records and statements of basis and purpose under the Administrative Procedure Act.

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[3] See, e.g., *Federal Communications Commission v. ITT World Communications, Inc.*, 466 U.S. 463 (1984) (international consultative processes leading to informal policy understandings are not covered by Government in the Sunshine Act); *Public Citizen v. United States Department of Justice*, 109 S. Ct. 2558 (1989); *Food Chemical News v. Young*, 900 F. 2d 328 (D.C. Cir. 1990); *Center for Auto Safety v. Federal Highway Administration*, No. C.A. 89-1045 (D.D.C. Oct. 12, 1990) (groups not formed by the Executive Branch are not "utilized" committees within the meaning of FACA).

Where the objective of harmonizing American and foreign agency rules has had a significant influence on the shape of the rule, that fact also should be acknowledged.

11. An agency that engages in systematic exchanges of information and consultation with foreign regulatory bodies should seek to ensure that domestic interests do not suffer competitive disadvantage from the release of valuable information by those bodies to foreign private interests. This may require that the agency seek to reach agreement with its foreign counterparts concerning the conditions under which information will be disclosed.

12. While harmonization of standards with foreign regulatory bodies may be a legitimate objective of any agency whose activities affect transnational interests or transactions (and therefore may appropriately influence the rulemaking outcome), it should be pursued within the overall framework of the agency's statutory mandate and with due regard for the interests that Congress intended the agency to promote. Accordingly, agencies should ensure that any accord informally reached through international regulatory cooperation is genuinely subject to reexamination and reconsideration in the course of the rulemaking process.

# Recommendation 91-2

## Fair Administrative Procedure and Judicial Review in Commerce Department Export Control Proceedings

The Export Administration Act (EAA), 50 U.S.C. App. §§2401-2420, authorizes the Commerce Department to restrict exports of goods and technology from the United States in the interests of national security, foreign policy objectives, and preservation of this country's access to commodities in short supply. It is the principal element in a scheme of export controls that emerged after World War II to serve three ends: reduction of the domestic impact of worldwide postwar shortages of critical goods, priority allocation of resources to rebuild Europe under the Marshall Plan, and restriction of the access of Eastern Bloc nations to technology useful for military purposes. Over the years, restricting access to useful technology has become the primary goal of the EAA, although the countries against which those restrictions are directed have changed from time to time in the light of shifting political considerations.

The EAA has an international aspect. The United States works with its allies through a coordinating committee on multilateral export controls (CoCom) to identify commodities that should be controlled as well as countries that should be the targets of various export controls. Using the lists thus generated, the Commerce Department is responsible, under the EAA, for a licensing scheme involving three different categories of licenses: 1) general licenses, which are applicable to most export transactions and permit them to occur without specific license applications; 2) individual validated licenses, which the agency grants or denies based on factors including concerns about the ostensible and the possible uses of the commodity, opposition from the Department of Defense or State to the proposed export, available information about the end-user, and policy determinations about the destination country; and 3) special licenses, such as distribution licenses and project licenses, that allow particular exporters to make multiple exports of certain types without applying for an individual license for each export. The Export Administration Act also contains provisions prohibiting participation in unsanctioned foreign boycotts and authorizes the Commerce Department both to make rules to carry out its provisions and to enforce its provisions, including the antiboycott provisions.

The EAA includes a provision explicitly exempting the Department's activities from the administrative process and judicial review provisions of the Administrative Procedure Act. As a result, administrative licensing decisions are final and unreviewable; agency rules implementing the EAA are subject neither to judicial review nor to the notice-and-comment requirements of 5 U.S.C. §553, although, in the latter respect, Congress has said that "to the extent practicable, all regulations imposing controls on exports. . . [should] be issued in proposed form with meaningful opportunity for public comment before taking effect." 50 U.S.C. App. §2412(b). Enforcement decisions are less affected by the exemption, as statutory amendments in recent years have imposed the formal hearing requirements of 5 U.S.C. §§556-57 on administrative enforcement proceedings and have authorized judicial review of enforcement decisions according to APA standards.

Because of the broad APA exemption, the Commerce Department has implemented the EAA with relatively little judicial scrutiny. It has had little incentive to provide generally accessible explanations for its actions. The EAA requires that license denials be accompanied by a written statement including, *inter alia*, a statement of the statutory basis for the denial; in practice, however, this statutory requirement has often been met in a minimal and uninformative way. Exporters have often been frustrated in their attempts to learn the reasons for negative licensing decisions or to predict the outcome of future license applications; they have also been without recourse to challenge Commerce Department actions as arbitrary or contrary to statute. Because legislation to reenact and amend the EAA is now pending,[1] reexamination of the APA exemption is timely.

The APA exemption dates back to passage of the first comprehensive export control legislation in 1949. At that time, Congress cited two reasons for the broad exemption: first, the legislation was seen as temporary, essentially an extension of emergency war measures, and second, it was closely related to foreign policy and national security concerns.

After more than 40 years, the export control program gives no indication of being "temporary," albeit sunset dates in the various export control statutes have necessitated several extensions and reenactments. Changes in the statute incident to reenactment and evolving policy at the Commerce Department have gradually increased access to information about the Department's actions and public participation in policymaking. Legislation to reenact the export controls program, passed in 1990 but subjected to a pocket veto by the President, would also have provided for limited judicial review of licensing decisions. But these measures still leave the relevant procedures well short of APA standards. And the need for such a broad exemption from APA provisions based on foreign policy and national security considerations is not at all clear. Much of the business conducted by the Commerce Department under the EAA is similar to that conducted by other regulatory agencies, and the interests at stake for potential exporters are similar to those of regulated entities under other licensing schemes. The agency can expect to benefit from public input in the rulemaking process just as other agencies do. Moreover, the APA includes specific exemptions from its rulemaking and formal adjudication provisions for agencies' military and foreign affairs functions, which would be available to reduce the required level of agency process when necessary,[2] as well as an exception to its judicial review provisions for action "committed to agency discretion by law." Other international trade and export control statutes, which presumably have foreign affairs implications, have operated successfully within this framework.

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[1] The Act expired on September 30, 1990; the export controls program continues in effect, however, by Executive Order issued under authority of the International Emergency Economic Powers Act, 50 U.S.C. §1702. Executive Order 12,730, September 30, 1990. Legislation to extend the export controls program was passed by Congress in 1990 but pocket vetoed by the President.

Increased availability of judicial review would help to ensure that the Department complies with applicable statutory standards and maintains a reasonable level of quality control in its decisionmaking under the EAA. While the presence of military and foreign affairs considerations will impel a reviewing court to give the Commerce Department great latitude to exercise its discretion, a court could usefully review many legal and factual issues under traditional APA standards without interfering with the executive branch's ability to conduct foreign policy or protect national security.

The Administrative Conference concludes, therefore, that the APA exemption is unnecessary and should be repealed. This conclusion is in accord with that of a recent National Academy of Sciences study on export controls, which also urges repeal of the APA exemption.[3] While the exemption repeal is the heart of this recommendation, the Conference also believes that various additional actions by Congress or the Commerce Department would be useful to enhance the benefits of making the APA applicable. These are explained briefly below.

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[2] The Administrative Conference has previously recommended that the military and foreign affairs exemption from APA rulemaking requirements be restricted to apply only where there is a need for secrecy in the interest of national defense or foreign policy. Conference Recommendation 73-5, *Elimination of the "Military or Foreign Affairs Function" Exemption from APA Rulemaking Requirements*, 1 CFR §305.73-5 (1991).

[3] Panel on the Future Design and Implementation of U.S. National Security Export Controls, "Finding Common Ground: U.S. Export Controls in a Changed Global Environment" (National Academy Press 1991).

**Judicial Review:** Although the Conference believes that, as a general matter, judicial review of Commerce Department actions under the standards of the Administrative Procedure Act is entirely appropriate, control of exports nevertheless remains a sensitive area. Thus, it is important to structure judicial review in a manner that will minimize the burdens on the conduct of foreign policy and national security affairs. Direct review in the court of appeals is appropriate here because of the policy considerations involved, because there are not likely to be large numbers of appeals, and because, in the case of rulemaking, the public interest will require prompt, authoritative determinations of a rule's validity. See Conference Recommendation 75-3, The Choice of Forum for Judicial Review of Administrative Action.[4] Consolidation of review of all export control matters in a single court of appeals would preserve uniformity in statutory interpretation and enable the court to develop expertise in the subject matter. Because it already enjoys some expertise in international trade and technological issues and is likely, based on its experience with many types of litigation involving the federal government, to be sensitive to the government's legitimate need for discretion in implementing export controls as well as to the interests of private parties, the Court of Appeals for the Federal Circuit is the most appropriate court for assignment of this responsibility.

**Informal Adjudications:** Under the APA, Commerce Department action on individual license applications should be treated as informal adjudication. While formal hearing proceedings are used to make decisions in some licensing programs administered by other agencies, there is no indication that such procedures are required here, and the high volume and time sensitivity of export license applications favor retention of the existing informal approach.

Another category of Commerce Department action handled informally is requests for advice as to the proper classification of a commodity. These requests permit an exporter to seek guidance concerning the appropriate category for an item on the list of controlled commodities (because different categories entail different export restrictions) and may be made at an exporter's option; such requests are appropriately treated as informal agency adjudication under the APA.

The Commerce Department should increase exporters' access to information about the decisions it makes in these informal adjudications. Clear statements of the agency's reasons for classifying exports in particular categories or denying licenses will both help exporters to determine how to proceed and provide a record for judicial review of the Department's action. Publication of those licensing and classification decisions that may have precedential value (along with a statement of the reasons for them) will benefit both agency and exporters by bringing a greater measure of predictability to the licensing process.

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[4] 1 CFR §305.75-3 (1990).

A special problem arises when license denials turn on classified information. The government has a strong interest in protecting the substance and sources of such information from disclosure, but, without access to the information that forms the basis for a license denial, it can be almost impossible for the exporter to evaluate whether the agency action is correct and to challenge the denial on administrative or judicial review. Steps should be taken to ensure that exporters (or their counsel) have the maximum feasible access to the information supporting the license denial and that agency staff claims that undisclosed classified information supports a denial are carefully scrutinized on administrative review.

**Formal Adjudications:** Current statutory provisions already make enforcement proceedings under the EAA (including both export control and antiboycott enforcement proceedings) formal adjudications by specifically applying sections 556 and 557 of the APA to those proceedings. Deletion of the general exemption from the APA would leave these procedures unchanged. To facilitate the consolidation of judicial review in one court and to conform to generally sound practice respecting administrative sanctions,[5] the Administrative Conference recommends one change in these enforcement procedures: that *de novo* district court penalty collection proceedings be eliminated in favor of on-the-record review in the Court of Appeals for the Federal Circuit, and that the Commerce Department have authority to collect its own civil penalties once the opportunity for judicial review has passed. Under this approach, failure to pay a penalty after it has become final and unappealable, or after the reviewing court has entered final judgment in favor of the agency, would result in a collection action in federal district court in which the validity and appropriateness of the order imposing the penalty would not be reviewable. This change would also have the effect of mooting a current controversy about whether the conduct of administrative enforcement proceedings tolls the 5-year statute of limitations for commencement of a district court action to collect a civil penalty.

The Commerce Department imposes sanctions without the benefit of formal adjudicatory procedures through the issuance of temporary denial orders and the suspension or revocation of licenses without notice or hearing under 15 CFR §770.3(b). Under the EAA, the Department may issue temporary denial orders denying exporting authority without notice where necessary to prevent an imminent violation of the EAA. Licenses may be suspended or revoked under Commerce Department regulations whenever the Office of Export Licensing believes that the terms and conditions of the licenses are not being followed, or when required to implement a change in regulatory policy.

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[5] See Conference Recommendation 72-6, *Civil Money Penalties as a Sanction,* 1 CFR §305.72-6 (1991); Conference Recommendation 79-3, *Agency Assessment And Mitigation of Civil Money Penalties*, 1 CFR §305.79-3 (1991).

Because these actions are taken to prevent imminent or continuing violations of the EAA, the Conference recognizes that the Commerce Department may need to take unilateral action. Nevertheless, when the circumstances requiring the action are individual to an exporter or a commodity and not, for example, related to an abrupt change in a destination country's status, exporters should be afforded a full opportunity to defend themselves in post-denial formal hearings. Existing procedures for temporary denial orders provide for prompt post-denial review, although without a full formal hearing; these existing procedures may offer a valuable avenue for seeking emergency relief from a denial order, but a full-scale administrative hearing should be available at the request of the party subject to the denial order. Concomitantly, judicial review of temporary denial orders, now governed solely by an arbitrary and capricious standard, should include substantial evidence review. At present, unilateral license suspensions are reviewable only through an informal agency process like that afforded license denials, and not at all in court. Because of their impact on existing economic relationships, the Administrative Conference believes suspensions grounded in the unique circumstances of a particular exporter or validated license should be followed by full formal procedures at the licensee's request.

**Rulemaking:** Once brought under the APA, Commerce Department rulemaking under the Export Administration Act would still be subject to the military and foreign affairs exception to notice-and-comment procedures; not every rulemaking under EAA necessarily falls within the terms of that exception, but some do. In recommending that the APA apply to export control proceedings, the recent National Academy of Sciences study proposed that section 13(b) of the EAA be retained, to reflect Congress' belief that military and foreign affairs considerations do not require that all EAA rulemakings fit the APA exemption and to encourage the Department to exercise some restraint in applying the exemption. The Conference endorses this recommendation.

The Conference also recommends that "foreign availability determinations," not specifically designated as rulemaking under the EAA, be so treated by the Commerce Department whenever possible. Under the Act, exports that would otherwise be restricted are permitted when the product involved is already available to the end-user from a foreign source. These determinations may often affect many potential exporters, rather than just one, and provision of an opportunity for public comment before making such a determination will enable Commerce to get a clearer picture of the relevant considerations. The Conference's recommendation, however, acknowledges that foreign availability determinations may sometimes initially arise in the context of license determinations where time is of the essence; in such cases, public comment might be solicited after the determination rather than before.

## RECOMMENDATION

1. **Repeal of APA Exemption.** Congress should repeal section 13(a) of the Export Administration Act, which exempts functions exercised under that Act from the administrative process and judicial review provisions of the Administrative Procedure Act (5 U.S.C. §§551, 553-559, 701-706).

2. **Judicial Review.** Congress should amend the Export Administration Act to provide for judicial review in a single forum, the United States Court of Appeals for the Federal Circuit, of all Commerce Department actions (including the imposition of civil penalties) under the Act that are reviewable by the standards of APA section 706.

3. **Informal Adjudications.** Requests for proper classification of proposed exports and applications for validated licenses or reexport authorizations are appropriately treated as informal adjudications under the APA. The Department of Commerce should make the following improvements in the applicable procedures:

    a. Whenever the Commerce Department initially denies a license application or responds to a classification request by placing the item in a category different from that proposed by the requester, it should provide sufficient written explanation for its decisions to enable applicants to understand the basis on which decisions have been reached and to pursue internal appeals.

    b. Review by the Secretary or the Secretary's delegate of staff decisions on classification requests or license applications should be available on request of the applicant. To the extent possible, the decision on review at the secretarial level should be in detail sufficient to permit others to evaluate its precedential value. The Commerce Department should publish and index these decisions in an appropriate manner, together with other decisions on requests for classification and individual license applications that have possible precedential value and any general written guidance on classification issues.

c. To eliminate a duplicative review procedure, Congress should repeal section 13(e) of the Export Administration Act, which provides for limited appeals of license denials through an administrative law judge hearing process.

d. When a license application has been denied, or has been the subject of negative consideration or recommendations under section 10(f)(2) of the Export Administration Act, based on classified information, the Commerce Department should adopt procedures to permit the maximum disclosure of such information consistent with national security and foreign policy (including, where appropriate, disclosure to the applicant or applicant's counsel under protective order). On administrative appeal of any license denial based on undisclosed classified information, the Secretary (or the Secretary's delegate) should personally review the classified information and certify that it is properly classified and supports the action taken.

### 4. Formal Adjudications.

a. Congress should amend the Export Administration Act to provide the right to a prompt post-denial (or post-suspension) hearing on the record, subject to the formal adjudication provisions of the Administrative Procedure Act, for parties subject (1) to unilateral Commerce Department decisions to suspend or revoke validated licenses when the suspension or revocation turns on the specific circumstances of a particular exporter or commodity, or (2) to temporary denial orders under section 13(d) of the Export Administration Act. Congress should establish appropriate deadlines for the conduct of such hearings.

b. The Commerce Department should, to the extent possible, limit the scope of unilateral license suspensions and temporary denial orders to the circumstances posing a threat of violation of the Export Administration Act.

c. Congress should amend the civil penalty provisions of 50 U.S.C. App. §§2410 and 2412 to eliminate the requirement of *de novo* proceedings in federal district court and provide instead that any assessment of civil penalties is final, subject to judicial review under 5 U.S.C. §706 in the Court of Appeals for the Federal Circuit; a civil penalty assessment that survives judicial review or becomes final without judicial review should be enforceable by the agency in a summary collection action in federal district court.[6]

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[6] See Conference Recommendation 72-6, supra n. 4.

5. **Rulemaking.**

a. Although the military and foreign affairs exemption of section 553 of the APA will be available to the Department of Commerce for some of its rulemaking under the Export Administration Act, the Conference supports the recent recommendation of the National Academy of Sciences that Congress should retain section 13(b) of the Export Administration Act. That section, which exhorts the Department to provide "meaningful opportunity for public comment" in departmental rulemakings "to the extent practicable," plainly expresses a congressional understanding that not all departmental rulemaking falls within the appropriate bounds of the military and foreign affairs exemption,[7] and thus appropriately encourages the Department to exercise restraint in its application.

b. To the extent feasible, the Department of Commerce should treat foreign availability determinations under sections 5(f)(1) and 5(f)(2) of the Export Administration Act as rulemaking within the terms of section 553 of the APA. Where, for reasons of time or other considerations, such determinations must be made in the context of decisions on individual license applications, the Department should publish the determination made with an invitation for public comment respecting related future determinations.

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[7] Cf. Conference Recommendation 73-5, supra n. 2.

# Recommendation 91-3

## The Social Security Representative Payee Program

As part of the Social Security program, Congress has authorized the Social Security Administration (SSA) to pay certain beneficiaries' benefits to other persons or organizations where the Secretary determines that payment to such a "representative payee" would be in the interest of the beneficiary.[1] SSA currently pays about $20 billion annually in social security benefits to representative payees of more than 4 million (or about 10%) beneficiaries. Because the program has been the subject of some concern and litigation, SSA asked the Administrative Conference of the United States to study certain procedural aspects of the representative payee program. While the study was underway, Congress addressed some of the procedural issues as part of the Omnibus Budget Reconciliation Act of 1990 (OBRA), Pub. L. No. 101-508, §5015.

### A. Rulemaking

The representative payee program operates under a statute that for the most part paints program requirements with a broad brush. SSA has some regulations, but many of the operating instructions are found in the Program Operating Manual System (POMS), the agency's internal operating manual. There are a number of issues the Conference believes should be the subject of regulations, either because they are not adequately addressed anywhere, or because they should be addressed in regulations rather than only in the POMS. These issues are discussed below. This recommendation contains specific suggestions for modifying the procedures for appointing representative payees (see section B, below). For a number of other issues involving the establishment of program criteria, the Conference takes no position on the content of the rules, but recommends that the issues be addressed in the context of notice-and-comment rulemaking.

First, there currently exists no clear standard for when a representative payee should be appointed in a particular case. The Social Security Act provides that "[i]f the Secretary determines that the interest of any individual under this title would be served thereby, certification of payment of such individual's benefit under this title may be made . . . [to a representative payee]."[2] The Act does not contain any standard for determining when appointment of a representative payee is in the beneficiary's interest. Current SSA regulations provide only that a representative payee will be appointed when "due to a mental or physical condition or due to . . . youth," a beneficiary is "not able to manage or direct the management of" his or her own benefits.[3] The regulations neither indicate what constitutes an inability to manage benefits, nor what mental or physical condition must be found. This lack of a standard requires SSA personnel to make largely discretionary decisions that are difficult to challenge individually or to evaluate programmatically.

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[1] The term "beneficiary" as used in this recommendation refers to those receiving benefits under both Tile II (old age survivors and disability benefits) and Title XVI (supplemental security income payments). Those receiving benefits under this latter program are technically referred to as "recipients."

While the Conference takes no position on what the substance of a standard for representative payee appointment should be, it believes that the promulgation of a more detailed standard through rulemaking is important to promote the appearance and reality of fairness and consistency in operation of the representative payee program.[4]

Second, concerns have been raised that persons interested in gaining access to beneficiary funds may provoke SSA action to appoint a representative payee without sufficient factual basis. Thus, a standard should be developed for the minimum amount of evidence necessary to trigger the initiation of procedures that could result in appointment of a representative payee.

Third, the Conference recommends that SSA promulgate clarifying rules relating to eligibility to serve as a representative payee, including a method for determining priorities where there are competing applicants for such payee status. Although SSA has some internal guidelines for selecting appropriate representative payees, the Conference believes that such issues should be addressed in regulations, to provide public participation in their development and to provide easier access to their contents.

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[2] 42 U.S.C. §405(j)(1) (Tile II). For Title XVI, the provisions are comparable. See 42 U.S.C. §1383(a)(2)(A).

[3] 20 CFR §§404.2001, 416.601 (1990).

[4] Among the issues that might be addressed are how the specific standard should balance interests in beneficiary autonomy versus government beneficence, what factors should be considered in determining whether a beneficiary's interest would be served by appointing a payee, what should constitute inability to manage benefits, and who should be the decisionmaker (e.g., the states in guardianship proceedings, the state disability determination services, or trained agency lay or medical staff). Any rule setting a standard for appointing a representative payee should also address the question of what types of evidence are either appropriate or necessary in making the determination.

SSA should also itself carefully consider the education levels and other qualifications of agency officials making determinations on representative payee status, to ensure that such decisionmakers have the necessary skills to apply whatever standard is developed.

Finally, the question of SSA's responsibility to monitor representative payee performance has been a subject of concern. Although a court has ruled that the Constitution's due process clause requires annual accounting by all representative payees,[5] the decision's continued applicability is not clear.[6] The Social Security Act currently requires annual accounting by representative payees, except certain institutions.[7] Congress in the OBRA amendments expressly required SSA to study more stringent monitoring of "high risk" payees (e.g., representative payees who are not related to the beneficiary or who are creditors). SSA should undertake rulemaking to promulgate procedures for monitoring representative payee performance in a manner that will be both effective and efficient.[8]

## B. Procedures

### 1. Current Procedures

When SSA receives information that a particular beneficiary may need a representative payee, it seeks to gather evidence with which to determine whether the beneficiary is incapable of managing his or her own benefits.[9] If SSA decides that the beneficiary is incapable, its first step is to select a representative payee. SSA then sends what is called an "advance notice" to the beneficiary, informing the beneficiary that he or she has been found incapable of managing benefits and that SSA intends to appoint the named representative payee. The beneficiary is allowed 10 days to respond to SSA and provide additional facts. This is often the first notice that the beneficiary receives that appointment of a representative payee is being contemplated. If, after receiving any further information, SSA confirms its decision, it sends the beneficiary notice of its "initial decision," which is implemented immediately. The beneficiary may seek "reconsideration" from SSA, following which the beneficiary is entitled to a hearing before an administrative law judge and appeal to the Appeals Council.

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[5] Jordan v. Schweiker, 744 F.2d 1397 (10th Cir. 1984); Jordan v. Bowen, 808 F.2d 733 (10th Cir. 1987).

[6] The *Jordan* case was a class action, certified in 1980. The court held that the Constitution required annual accounting for all payees. The impact of time on the class, as well as the impact of subsequent legislation, raises some questions concerning the case's current applicability.

[7] 42 U.S.C. §405(j)(3).

[8] Such a rulemaking could address such issues as what type of information is needed to make decisions, how often it should be reported or collected, whether different requirements should apply to different types of payees, and what SSA will do with the information it obtains in terms of its internal use and public availability.

[9] Such evidence may include state adjudications of incompetence, a physician's opinion that a beneficiary is unable to manage benefits, or lay evidence to that effect.

Under these current procedures, the beneficiary generally is provided no notice that SSA is considering appointing a representative payee until the agency has already preliminarily decided that one is necessary and has selected a candidate. The "advance notice" does not explain the basis for the decision to appoint a representative payee. Nor is the beneficiary given an opportunity to meet with SSA face-to-face before a representative payee decision is implemented. While the present procedures appear to satisfy constitutional minima, considerations of efficiency, fairness and appearance of fairness suggest certain modifications to these procedures.

### 2. Conference Recommendations

The Conference recommends several changes in the process, that, consistent with its other recommendations involving the Social Security program, encourage increased procedural safeguards at the beginning of the process in order to maximize correct decisions in the early stages and lessen the need for additional proceedings.[10] The Conference recommends that SSA notify a beneficiary as soon as the threshold for initiating action, discussed above, is met, offering the beneficiary an opportunity to have an informal face-to-face interview with an SSA claims representative. To the extent practicable, the notice (and all other notices) should be designed to be understandable to the beneficiary, taking into consideration information already in the file (e.g., what language the beneficiary understands).[11] The notice should also inform the beneficiary that appointment of a representative payee is being considered, describe the standard for and basic reason(s) why it is being considered, ask for all relevant information concerning the need for and selection of a representative payee, and ask the beneficiary to suggest a possible candidate. SSA should also notify the beneficiary of any person(s) it knows to be under consideration as a representative payee.

If, after completing its investigation, SSA decides to appoint a representative payee, it should notify the beneficiary of this determination, informing him or her of the right to review the evidence and appeal.[12] The determination then would be implemented, after which appeal to an ALJ and the Appeals Council would be available, as it is now. These procedures would eliminate the current opportunity for "reconsideration" that is provided after implementation but before the ALJ hearing.

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[10] See, e.g., Recommendation 90-4, "The Social Security Disability Program Appeals Process: Supplementary Recommendation," 1 CFR §305.90-4.

[11] The expectation is that there would be several form notices with the clearest practicable wording in different languages, normal and large type sizes, and perhaps braille.

[12] OBRA amendments require such notice. See 42 U.S.C. §§405(j)(2)(E); 1631 (a)(2)(B) (x)-(xii).

The rationale for these recommended procedures is that a beneficiary should have notice and the opportunity to respond concerning his or her alleged inability to manage benefits before the SSA has made a de facto determination that a representative payee is required and who that payee should be. The ability to manage benefits is not always strictly a medical determination; it may well involve consideration of observed behavior. Thus, it is likely that a decisionmaker who has had an opportunity to see and talk with the beneficiary will often make a more accurate determination of the need for a representative payee.[13] The Conference believes that, as in the disability adjudication itself, procedures that encourage as complete a record as early in the process as possible offer significant advantages that far outweigh any short-term costs occasioned by adding an earlier notice and opportunity for a face-to-face meeting. Not only will early notice to beneficiaries and an opportunity for personal contact with SSA allow beneficiaries to provide any relevant information that they have at a predecisional level, it may also give them more confidence in the process, thus resulting in fewer appeals at later stages. Moreover, as noted above, the opportunity for "reconsideration" that is currently provided after implementation but before the ALJ hearing would no longer be required.

Under current procedures, beneficiaries are permitted to have assistance, by attorneys or nonattorneys, in disputes over representative payee status. However, because of the lack of formal procedures until late in the process and, more important, the lack of an "award" out of which to pay attorneys, there has been little attorney or lay assistance involvement in this program. It would thus be especially useful for SSA to develop and provide beneficiaries with information about legal assistance and other relevant organizations that may be available in their areas.[14]

In situations where someone applies to replace a representative payee, both the payee and the beneficiary should be given notice of the possible replacement. Both should be given an opportunity to file comments and to meet informally with SSA officials. If the representative payee is replaced, the beneficiary (but not the payee) should have the right to appeal the determination.

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[13] The Conference has recommended that face-to-face meetings be available in the context of medical disability determinations. Recommendation 89-10, "Improved Use of Medical Personnel in Social Security Disability Determinations," 1 CFR §305.89-10.

[14] The Conference has encouraged the use of nonlawyers in agency proceedings. See Recommendation 86-1, "Nonlawyer Assistance and Representation," 1 CFR §305.86-1.

Although a beneficiary in representative payee status may apply to have such status terminated, no procedure currently exists for reexamining the need for a representative payee on any periodic basis. Because there are certain types of beneficiaries for whom a representative payee is less likely to be needed permanently (e.g., stroke victims, persons with reactive depression), it is in the interests of both the agency and beneficiaries to reassess periodically the need for representative payees for such individuals. Thus, the Conference recommends that SSA attempt to determine which, if any, types of beneficiaries in representative payee status ought to have their status periodically reevaluated and provide a method for doing so.

## C. Misuse of Funds and Restitution

### 1. Current Practice

Curently, determinations by SSA that beneficiary funds have been misused are not appealable. This means that neither the beneficiary nor the representative payee may challenge such determinations. Moreover, SSA does not currently have an effective mechanism for requiring payees who misuse beneficiary funds to return such funds to beneficiaries.[15] SSA currently has only the options of referring cases to the Department of Justice for criminal prosecution or requesting the representative payee to return funds. Most cases are too small to warrant Justice Department action, and SSA has no authority to force a representative payee to pay restitution.

### 2. Conference Recommendations

Beneficiaries should be permitted to appeal an administrative determination that their benefits have not been used properly.[16] Representative payees should also be permitted to appeal misuse determinations. Although they have no right to payee status, a determination that they have misused funds will be entered into a data bank, will prevent them from being appointed as a representative payee in the future, and may have other negative ramifications. These consequences suggest that more process may be due. The Conference recommends that a determination of whether representative payee misuse of beneficiary funds has occurred be considered an "initial determination," which triggers the right to reconsideration and, if necessary, a subsequent ALJ hearing.

The Conference also recommends that Congress authorize an administrative remedy that would allow SSA to (1) require representative payees who have misused beneficiary funds to pay restitution, and (2) impose civil monetary penalties on such payees. Such authority would enable SSA to address the problem without burdening the courts.[17]

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[15] In cases where SSA has been negligent in investigating or monitoring representative payees, SSA must make restitution to the beneficiary. OBRA §5105(c).

[16] Beneficiaries do have the right to use state court remedies.

The OBRA amendments made clear that, where SSA's negligent failure to investigate or monitor a representative payee results in misuse of benefits, SSA must make restitution to the beneficiary for any such benefits, and then may seek repayment from the payee.[18] The negative impact on a beneficiary caused by misuse of his or her benefits, however, is independent of whether any SSA negligence was involved. Congress should authorize research on the scope, causes and effects of representative payee misuse of benefits, and methods to ease the resulting burden on beneficiaries, including the use of loss underwriting arrangements.

### D. Other Issues

When this study was undertaken, the issue of SSA's need to investigate representative payees before their appointment was of major concern. The recent OBRA amendments, however, require SSA to undertake certain investigations of potential representative payees. For the present, those steps would appear to be adequate, but, after sufficient time has passed, their effectiveness should be reevaluated.

In the past, where SSA has determined that a representative payee is required, but has not found a suitable candidate, SSA has suspended benefit payments until a payee could be found, at which time the withheld payments would be released to that payee. In the OBRA amendments, Congress authorized SSA to suspend payments for no more than 30 days, where direct payment would substantially harm the beneficiary. However, where the beneficiary is legally incompetent, under the age of 15, or a drug addict or alcoholic, there is no time limit on the suspension of benefits. The Conference believes that SSA should study the impacts of the indefinite suspension of benefits on beneficiaries in these groups, with the objective of making legislative recommendations to Congress if the study suggests that time limits should exist for all classes of beneficiaries or that suspension should not permitted at all.

In many cases, finding an appropriate representative payee is a significant problem. SSA should take steps to ease its burden by widening the pool of potential representative payees, and by periodically seeking input from beneficiaries. It would be useful for SSA to ask beneficiaries, at the time that they apply for benefits and periodically thereafter, to designate a person who, at that time, they would prefer to serve as a representative payee, should one become necessary. While such a designation would not bind the agency, in many cases, the designation of someone who the beneficiary thought was appropriate could make the selection process easier for SSA and make the beneficiary more comfortable with the representative payee. SSA also should develop lists of national, regional and local organizations that could serve as representative payees on a volunteer basis, and evaluate carefully the performance of these and compensated or reimbursed representative payees.[19]

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[17] See Recommendation 72-6, "Civil Money Penalties as a Sanction," 1 CFR §305.72-6; Recommendation 79-3, "Agency Assessment and Mitigation of Civil Money Penalties," 1 CFR §305.79-3. The Program Fraud Civil Remedies Act, 31 U.S.C. §3801, authorizes the imposition of administrative civil penalties for false claims against the government and for certain types of false statements. However, it is not clear whether this Act would apply to representative payee actions, and in any event, it does not provide a remedy of restitution.

[18] OBRA §5105(c)(1), to be codified at 42 U.S.C. §405 (j)(5).

## RECOMMENDATION

1. The Social Security Administration (SSA) should develop and promulgate by regulations criteria for deciding the following issues:

    (i) Whether appointment of a representative payee should be made;

    (ii) What evidence constitutes a threshold for initiating procedures that could result in appointment of a representative payee;

    (iii Who is eligible for appointment as a representative payee and whether the existing priorities among categories of payees should be modified, including which payee should be selected when there are competing payee applicants from the same category of payee; and

    (iv) How payee performance should be monitored and evaluated.

2. SSA should amend its procedures for appointing representative payees for beneficiaries[20] aged 15 and above as follows:

    (a) At such time as the threshold described in ¶1(a)(ii) is met, SSA should send a notice to the beneficiary that, to the extent practicable, is in language designed to be understandable to the beneficiary. This notice should contain the following information:

        (i) That representative payee status is being considered;

        (ii) A description of the standard for appointment of a representative payee;

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[19] Congress has authorized the use of reimbursed representative payees on a very limited basis. OBRA of 1990, Pub. L. No. 101-508, §5105(a)(3).

[20] The term "beneficiary" as used in this recommendation refers to those receiving benefits under both Title II (old age survivors and disability benefits) and Title XVI (supplemental security income payments) of the Social Security Act.. Those receiving benefits under this latter program are technically referred to as "recipients."

(iii) A request that the beneficiary provide all information relevant to the need for and selection of a payee;

(iv) An offer for the beneficiary to meet in an informal face-to-face interview with an SSA representative;

(v) The names of any person(s) known by the agency to be under consideration as a representative payee, and a request for suggestions for possible representative payees, should one be determined necessary; and

(vi) A statement that the beneficiary may be assisted by an attorney or other person, and a list of legal aid and other relevant resources available in the area.

(b) If, after completion of the above procedures, a determination is made to appoint a representative payee, the beneficiary should be notified of the bases for that determination, the name of the payee, and the beneficiary's appeal rights. These should include the right to an administrative law judge hearing and review by the Appeals Council, but the currently provided "reconsideration" stage that precedes the ALJ hearing could be eliminated upon implementation of this recommendation.

(c) Direct payment should continue to the beneficiary until a representative payee appointment is effective.

3. Where a person applies to replace an existing representative payee, SSA should give notice to the beneficiary and to the existing payee. The notice to the beneficiary and to the payee should offer them the opportunity to meet in an informal face-to-face interview with an SSA official and to provide any relevant information, in writing or orally. If the existing payee is replaced, the beneficiary should be notified of the replacement and of his or her right to an ALJ hearing on the decision and review by the Appeals Council.

4. SSA should attempt to determine which, if any, type of beneficiaries in representative payee status are most likely to regain their ability to manage or direct the management of their own benefits, and provide a method for periodic reevaluations of their need for a representative payee.

5. SSA should amend its regulations to provide that a decision on whether beneficiary funds have been misused by representative payees should be considered an "initial determination" appealable by either the beneficiary or the representative payee.

6. SSA should take the following steps to facilitate the search for appropriate representative payees:

(a) At the time of application for benefits and periodically thereafter, request beneficiaries to identify their current choice of a representative payee who could be considered for the position, after appropriate investigation, in the event that one may be required in the future.

(b) Identify and use national, regional and local organizations that offer representative payee services on a volunteer basis and evaluate their performance in light of other representative payees.

(c) Evaluate the need for further use of organizations that serve as representative payees on a reimbursed or compensated basis.

(d) To the extent possible, make referrals to social welfare agencies or take other appropriate action to ensure that beneficiaries for whom representative payees are not available are not harmed by the absence of the social security benefits.

7. Congress should authorize SSA to use administrative adjudications to require representative payees who have misused beneficiary funds to pay restitution and to impose civil monetary penalties on such payees.

8. Congress should authorize research on the scope, causes and effects of representative payee misuse of benefits, and methods to ease the resulting burden on beneficiaries, including the use of loss underwriting arrangements.

9. SSA should develop data and study the effect on beneficiaries of suspending benefits when a representative payee is not available, with the objective of making recommendations on whether there should be time limits on suspension of payments for all categories of beneficiaries or whether suspensions should not be permitted at all.

# Recommendation 91-4

## The National Vaccine Injury Compensation Program

The National Vaccine Injury Compensation Program (the Program), sections 2110 *et seq.* of the Public Health Service Act, codified at 42 U.S.C. §§300aa-10 *et seq.*, is a federal compensation system for permanent injuries and deaths resulting from vaccines to prevent seven infectious diseases of childhood (diphtheria, tetanus, whooping cough, measles, mumps, rubella, and polio). State laws generally require that children be immunized against such diseases for school entry.

The Program, which became effective October 1, 1988, is unique among federal benefit programs in its organizational structure and decisionmaking processes. It was intended to provide an alternative to the tort system for dealing with claims of vaccine-related injury, awarding compensation quickly, fairly, and efficiently. It was also intended to contribute to improving immunization rates, stabilizing the supply and price of vaccines, encouraging new and improved vaccines, and reducing the burden and uncertainty of litigation.

Decisionmaking authority is vested in the United States Claims Court. Claimants submit petitions for compensation to the Claims Court, and bear the burden of proving both entitlement and the losses and expenses to be compensated. The Secretary of Health and Human Services (HHS) is designated as respondent. The National Vaccine Injury Compensation Program Office in HHS (the Program Office) acts on behalf of the Secretary and may oppose compensation in individual cases. The vaccine manufacturer and whoever administered the vaccine are not involved as a party to the proceedings.

Two procedural innovations in the Program are especially noteworthy. First, determinations of eligibility and the amounts of compensation are made by special masters employed by the Claims Court. Under current procedures, the special master issues a judgment that is final unless review by a Claims Court judge is requested by either claimant or respondent. Further review is available in the United States Court of Appeals for the Federal Circuit.

Second, the Act contains a Vaccine Injury Table, which defines the injuries compensable under the Program. This was a policy decision by Congress, intended to avoid controversy over what disabilities were in fact caused by vaccines and to expedite decisions on claims by eliminating difficult, time-consuming disputes over causation in individual cases.[1] Nevertheless, disputes over whether particular injuries qualify for compensation have sometimes proved time-consuming, even though the Table is accompanied by "Qualifications and Aids to Interpretation." Moreover, in cases of injury, determining the amount of compensation can be difficult and time-consuming because of the need to take into account the net present value of actual unreimbursable expenses for medical, rehabilitative, and custodial care, actual and anticipated lost earnings, and actual and projected pain and suffering. Paragraphs 2, 3, and 4 address these issues by suggesting that Congress consider whether further clarification would be appropriate, and by recommending development of guidelines that may be used by the Claims Court and the parties. Paragraph 5 suggests study of ways to minimize transaction costs in administering awards under the Program.

The Department of Justice has recently taken steps to speed the processing of vaccine cases by increasing the Assistant Attorney General's settlement authority and modifying its settlement review and approval procedures.[2] Paragraph 6 encourages continued review of the appropriate level of such authority.

No one administrative agency is charged with the duty of interpreting the enabling legislation or issuing general regulations. The Advisory Commission on Childhood Vaccines is empowered to advise the Secretary of HHS on Program implementation. The Secretary may revise the Vaccine Injury Table, but has no authority to impose decisionmaking rules on the United States Claims Court. The Secretary was also required to develop and disseminate vaccine information materials, including a summary of the availability of the Program, not later than December 22, 1988.[3]

Claimants may seek compensation under the Program regardless of when the injury occurred. However, the starting date of the Program, October 1, 1988, serves as a line of demarcation between two somewhat different sets of rules and remedies. Claims based on immunizations prior to that date--"retrospective cases"--may not have received an award based on a judgment or settlement in a civil action. Awards in retrospective cases are paid out of a limited fund specially authorized by Congress.

For injuries arising from immunizations on or after October 1, 1988--"prospective cases"--no civil action may be filed unless the claimant has filed a claim under the Program and received and rejected a determination under it.

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[1] The Act also allows for compensation if a petitioner can prove that an injury was actually caused by a covered vaccine, even if the specific injury is not listed in the Table.

[2] See 56 Fed. Reg. 8923 (March 4, 1991).

[3] A proposal was published at 54 Fed. Reg. 9180 (March 3, 1989), but the final version has not been published as of the date of this recommendation.

For such cases, the Program is a "first resort," but not an exclusive source of compensation. Awards for prospective cases are paid from the Vaccine Injury Compensation Trust Fund supported by a tax on covered vaccine sales. The Act tolls the statute of limitations governing the civil action until a final judgment is issued on the petition. This tolling provision was intended to preserve a petitioner's right to commence a civil action after the petitioner has exhausted the remedies under the Act. However, because the petitioner has 90 days to accept or reject a final judgment by the Claims Court or the Court of Appeals, the immediate end to the tolling upon final judgment might operate to extinguish an unwary petitioner's right to commence a civil action. Paragraph 7 would remedy this anomaly.

Under the Act, as amended, a final deadline of January 31, 1991, was set for filing claims in retrospective cases. More than 3000 cases were filed in the 5 months preceding this deadline, the vast majority of them retrospective. The large number of filings during this period has created an unusual burden on the Program that can be expected to dissipate in the next few years, as a more regular pattern of filing claims develops. However, a special response, as suggested in paragraph 8, is warranted to ease the temporary burden of deciding these petitions. Measures suggested include a temporary increase in staffing, with funding to support the additional positions.[4] Paragraph 9 is intended to address the possibility that there will be insufficient funding due to the substantial number of retrospective cases that have been filed; under the statute the Program would cease to be in effect if there are insufficient funds to pay all of the claims payable for 180 days.

The Claims Court has used teleconferencing successfully in connection with the Program. Congress may find it useful to study this experience and to consider the possible use of the technique in other proceedings.

Finally, we note that section 2117 of the Act grants the Trust Fund the right of subrogation for compensation paid under the Program. The Departments of Health and Human Services and Justice should continue to be alert to appropriate opportunities to pursue this course.

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[4] Congress should consider the effects on the Program if money in the Vaccine Injury Compensation Trust Fund is used for this purpose. Currently, section 6601(r) of the Omnibus Budget Reconciliation Act of 1989, Pub. Law No. 101-239, 103 Stat. 2293, authorizes separate appropriations of funds to HHS, Justice and the Claims Court (for FY 1990 and 1991) from the Trust Fund.

# RECOMMENDATION

1. The National Vaccine Injury Compensation Program Office in the Department of Health and Human Services, in consultation with the Advisory Commission on Childhood Vaccines, should continue to explore additional effective ways and take appropriate steps to disseminate information nationally about the Program, including eligibility and documentation requirements and filing deadlines for petitions, to ensure that affected persons are aware of the available legal remedies and to help them identify necessary supporting information.

2. To simplify the process of determining eligibility, Congress should examine whether further clarification is needed of the "Qualifications and Aids to Interpretation" applicable to the Vaccine Injury Table, which are set forth in section 2114(b) of the Act to explain the symptoms and conditions to be considered evidence of an injury described in the Table.[5]

3. The Advisory Commission on Childhood Vaccines should develop uniform guidelines, such as discount rates for the value of medical and other services to be purchased in future years, for calculating the net present value of specific elements of compensation to be awarded to petitioners. Such guidelines may be used to compute the amount of awards promptly and consistently in similar cases. The guidelines should be reviewed at least annually to ensure that they remain consistent with reasonable estimates of future economic performance.

4. The Advisory Commission on Childhood Vaccines should also consider developing guidelines for the total amount of compensation payable and, where appropriate, for individual elements of compensation, in light of evolving case law and experience with the alternative dispute resolution process used by the Claims Court. The guidelines should provide for appropriate variations on the basis of age, severity of injury, intensity of services, and other relevant factors. The guidelines should present a range of values in each category, with flexible ceilings and floors, to accommodate special circumstances.

5. The Department of Health and Human Services and the Advisory Commission on Childhood Vaccines should study the current use of brokers to provide structured settlements, and should explore alternatives that will decrease transaction costs that result in reducing the funds available for awards to plaintiffs.

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[5] Congress may also wish to consider any relevant information from the studies performed by the Institute of Medicine of the National Academy of Sciences pursuant to Pub. L. No. 99-660, 100 Stat. 3779, §§312,313.

6. The Department of Justice should continue to examine the appropriate level of approval authority and dollar limit for settling vaccine injury cases, taking into account the magnitude of awards actually made under the Program, to reduce delay in obtaining final approvals.

7. Congress should amend section 2116(c) of the Act to stay the statute of limitations governing civil actions for personal injuries arising out of a vaccination covered by the Act until the date that the petitioner files an election, or is deemed to file an election, pursuant to section 2121 of the Act, accepting or refusing to accept the judgment.

8. Congress should take the following steps to reduce the burdens placed upon the Program by large fluctuations in the numbers of petitions filed:

(a) Congress should delete section 2121(b)(2) of the Act, as added by the Vaccine and Immunization Amendments of 1990, which withdraws jurisdiction over any petition that is not decided within the time required by the Act.

(b) Congress should amend section 2112(d)(3) of the Act, as amended by the Vaccine and Immunization Amendments of 1990, to permit the chief special master to extend the time for deciding petitions filed in retrospective cases for up to 2 years, in addition to the 240-day time limit plus all other extensions and suspensions currently permitted, when the chief special master determines that the number of filings and resulting work load require such action in the interest of justice.

(c) Congress should amend section 2112(c)(1) of the Act to increase substantially the authorized maximum number of special masters to handle the temporary burden of decisionmaking in retrospective cases. Congress should also authorize additional funds for a limited time period to support these positions, as well as increased staffing needed within the Program Office and the Department of Justice.

9. Congress should address the potential consequences if there were to be insufficient funding for the Program, in view of section 323(b) of Pub. L. No. 99-660, 100 Stat. 3784, which provides that the Program shall cease to be in effect if there are insufficient funds to pay all of the claims payable for 180 days.

10. Congress should extend the January 1, 1992 deadline for the Secretary of Health and Human Services to report the results of the evaluation of the Program required by section 6601(t) of the Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, 103 Stat. 2293, until the temporary burden of retrospective cases is substantially reduced, because inclusion of information with respect to these cases is essential to a useful evaluation of the Program.

# Recommendation 91-5

## Facilitating the Use of Rulemaking by the National Labor Relations Board

The National Labor Relations Board (the Board) has formulated policy almost exclusively through the process of administrative adjudication despite having been granted both rulemaking and adjudicatory power in its statutory charter more than half a century ago. Even as rulemaking eclipsed adjudication as the preferred method of policymaking among major federal agencies, the Board steadfastly relied upon the quasi-judicial approach.

The appropriateness of agency discretion to choose between rulemaking and adjudication to determine policy has been widely acknowledged. In the last several decades, however, the use of rulemaking in major federal agencies has grown and a body of commentary and judicial opinion has encouraged and approved this trend. Agency power to use rulemaking authority to resolve by general principle issues that recur in adjudicatory hearings has been broadly asserted and approved. Gains in administrative efficiency through the use of rules have been frequently seen as outweighing the benefits of incremental policymaking through case-by-case consideration. Controversy, then, has centered on the Board's insistence on adjudication as virtually the only means for the development of policy and on the practical implications this has had for the Board's accomplishment of its regulatory mission.

The type of decisionmaking engaged in by the Board has implications for the type of data gathered by the Board and the openness of policymaking. Policy formulated in the context of case-by-case adjudication is based solely upon the argument and evidence that the parties to the proceeding offer. Rulemaking, however, offers broader opportunity for public participation and more meaningful notice to affected parties of potential changes in regulatory standards.

In addition, the choice between rulemaking and adjudication may affect the clarity and stability of the particular policy involved. In general, rulemaking provides greater clarity in the identification of a decision as a policy choice and requires that agency policy not be changed without a process focused on the policy choice. Where bright line rules are helpful and feasible, this may be an important consideration. Rulemaking also can resolve more efficiently important policy choices that would require a series of adjudications over a long period of time; thus, it can promote efficient enforcement of agency policy. Moreover, rulemaking enables the Board to set its policymaking agenda internally and directly with a view toward enforcement needs, rather than depending on the issues presented in cases that parties choose to press.

Despite its historical reluctance to formulate policy through rulemaking, the Board announced in 1987 its intention to initiate a rulemaking proceeding to determine bargaining units in health care facilities.[1] The Board's choice of this subject for its first major substantive rulemaking is inextricably intertwined with the agency's struggle with it for almost 15 years. The Board gave two rationales for its decision to use rulemaking. First, the Board believed that there would be value in obtaining from affected parties empirical data on the effect on labor relations of unit configuration in the health care industry. Second, the Board acknowledged the longstanding criticism of its reluctance to use rulemaking as a policymaking vehicle and concluded that rulemaking, though perhaps time consuming at the outset, might prove valuable over the long term in terms of the predictability and efficiency of determinations of viable bargaining units in the health care industry.

While the notice-and-comment procedures of §553 of the APA require only an opportunity for written comments on the proposed rule, the Board decided to hold four public hearings around the country to receive oral and written comments, and to permit limited cross-examination. The Board provided for greater public participation than was strictly required because it desired to assure affected persons that there would be the fullest opportunity to participate as the Board undertook a new method of policy formulation. In addition, the Board was concerned that without oral testimony and cross-examination, it would receive (through written comments) only the kind of legal arguments that it traditionally heard in adjudications. A final rule was adopted on April 21, 1989. Judicial review was sought by the American Hospital Association (on the grounds that the rule exceeded the Board's statutory authority, the Board was required by statute to make unit determinations on a case-by-case basis, and that the rule was arbitrary and capricious).[2] The Supreme Court ultimately upheld the rule.

The Conference has examined the Board's "experiment" with rulemaking. Putting aside the particular legal issues yet unresolved in the "test" case before the courts, it seems clear that the proceeding accomplished the major putative purposes of rulemaking. First, the Board accumulated and utilized an enormous volume of empirical data that had not been available to it in previous adjudications. Second, the process provided a degree of openness and broad-scale participation unmatched by traditional Board proceedings (even in those few adjudications where amici are invited to an oral argument). Third, the product of the rulemaking is a model of clarity as expression of policy in an area historically marked by excessive subtlety and complexity. Finally, the rule, if upheld, promises a degree of stability for a policy area that had been overwhelmed by change.

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[1] 52 Fed. Reg. 25,142 (1987).

[2] The U.S. District Court for the Northern District of Illinois found the rule unlawful and granted a permanent injunction against its enforcement. The U.S. Court of Appeals for the Seventh Circuit reversed the district court decision. The Supreme Court granted certiorari and issued a unanimous decision upholding the Board rule and recognizing the Board's broad rulemaking powers under §6 of the National Labor Relations Act. See 111 S. Ct. 539 (1991).

It cannot be said, however, that the Board's choice to use rulemaking represents a broad new commitment to formulating national labor policy by this means. This rulemaking was an exercise in pragmatism--a thorough, careful, and productive administrative response to a particular set of circumstances. Nevetheless, the rulemaking gives the Board experience upon which it can build. This recommendation, while recognizing that the Board will justifiably continue to make policy through adjudication, suggests steps to facilitate further rulemaking by the Board. These steps include publishing standard rulemaking procedures, identifying subjects that are appropriate for rulemaking, and amending the National Labor Relations Act to include a provision that (following previous Conference reocmmendations) specifies an appropriate procedure for judicial review of Board rules.

## RECOMMENDATION

1. The National Labor Relations Board should supplement its practice of policymaking through case-by-case adjudication by continuing to use its general rulemaking authority in appropriate situations.

2. To facilitate the rulemaking process, the Board should take the following steps:

*(a) Rulemaking procedures*

The Board should publish rulemaking procedures that conform to the informal rulemaking procedures of the Administrative Procedure Act. These procedures should not require oral hearings or other procedures in addition to notice and the opportunity for comment, as a general matter, although such additional procedures may be useful for particular rulemakings.[3]

*(b) Identification of subjects for rulemaking*

To assist the Board in identifying manageable and timely subjects for which rulemaking might be appropriate, it should consider, among others, the following factors:

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[3] See Conference Recommendation 76-3, "Procedures in Addition to Notice and the Opportunity for Comment in Informal Rulemaking," 1 CFR §305.76-3 (1990).

(i) The need for submissions and information, including empirical data, beyond that normally available through adjudication.

(ii) The value of participation by affected persons beyond the parties likely to participate in adjudication, with particular attention to possible reliance on prior policy and the breadth of impact of a new policy.

(iii) The need to establish policy promptly in new areas of responsibility or for new enforcement initiatives.

(iv) The opportunity for stabilizing policy in the particular subject area.

(v) The likelihood that future litigation and enforcement costs may be lessened if a readily applicable rule is developed.

(vi) The need to achieve control over the subject and timing of policy review and development.

*(c) Existing law*

The Board should develop a policy to govern situations in which the subject of a proposed rule has already been the focus of consideration in prior adjudicatory proceedings. The Board should seek to anticipate enforcement issues that may arise during the pendency of the rulemaking and possible judicial review. During the pendency of a rulemaking, the Board and its independent General Counsel ordinarily should continue to act under its body of precedent, but they should be prepared to depart from precedent in individual cases where the application of such precedent would be unfair or inefficient.

3. Congress should amend the National Labor Relations Act to confine preenforcement review of final Board rules to a single proceeding. Review should be authorized in the appropriate court of appeals.[4] This authorization should include a reasonable time limit on the seeking of preenforcement review and preclude judicial review of rules at the enforcement stage concerning issues relating to whether (a)the procedures employed in the rulemaking were adequate, or (b)there was adequate support for the rule in the administrative record.[5]

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[4] See Conference Recommendation 75-3, "The Choice of Forum for Judicial Review of Administrative Action," 1 CFR §305.75-3 (1990).

[5] This is not meant to limit parties' ability, at the enforcement stage, to challenge a rule as arbitrary and capricious as applied. See Conference Recommendation 82-7, "Judicial Review of Rules in Enforcement Proceedings," 1 CFR §305.82-7 (1990).

# Recommendation 91-6

## Improving the Supervision of the Safety and Soundness of Government-Sponsored Enterprises

The federal government has established and chartered numerous "government-sponsored enterprises"[1] (GSEs) to facilitate the flow of credit to certain categories of borrowers, such as homebuyers, farmers and students. GSEs do this by raising funds in the capital markets to make or purchase loans or by guaranteeing securities based on pools of loans. GSEs share many attributes of private companies: they are privately owned, sell stock, are generally profit-making institutions, and are exempt from federal civil service, procurement and appropriations restrictions. However, they also share many characteristics of public institutions. They usually have some government-appointed directors on their boards; they have charters that preempt some state laws and exempt them from many taxes; and, for many of them, the federal Treasury is statutorily authorized to invest in stated amounts of their securities. Moreover, their obligations and mortgage-backed securities are implicitly (but not explicitly) guaranteed by the federal government, thus raising the value of these securities while creating at least some risk for the taxpayers by virtue of the implicit guarantees of almost one trillion dollars in the aggregate.

In July 1989, the Conference began a study of the structures and procedures employed by the government to oversee the safety and soundness of these institutions.[2] During the pendency of the study, numerous other legislative and executive branch studies of the operations of the GSEs have been completed.[3] The Conference has been informed by all of these studies in its consideration of this recommendation and it recognizes the desirability of the current examination of these institutions. In so saying, the Conference wishes to make clear that it implies no special concern about the financial condition of any of these entities--indeed, the studies concluded that they pose no imminent financial threat. But in the past some GSEs have encountered financial difficulties, and concerns have been raised about the capital adequacy of some GSEs and their possible vulnerability to economic downturns. Accordingly, it is prudent to ensure that adequate federal supervisory mechanisms are in place before, rather than after, they might be needed.

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[1] A Government-sponsored enterprise is a privately owned, federally-chartered financial institution with nationwide scope and specialized lending powers that benefits from an implicit federal guarantee to enhance its ability to borrow money. See Stanton, *Administrative and Legal Aspects of Federal Supervision of Safety and Soundness of Government Sponsored Enterprises*, Report to the Administrative Conference (May 1991) at 3 [hereinafter, Stanton Report].

[2] Stanton Report, *supra* note 1.

[3] Congressional Budget Office, *Controlling the Risks of Government-Sponsored Enterprises* (April 1991); General Accounting Office, *Government-Sponsored Enterprises--The Government's Exposure to Risks*, (GAO/GCD - 90-97) (August 1990); General Accounting Office, *Government-Sponsored Enterprises: A Framework for Limiting the Government's Exposure to Risks* (GAO/GGD - 91-90, May 1991); Office of Management and Budget, *Budget of the United States Fiscal Year 1991*, Chapter VI, pp. 231-255; Treasury Department, *Report of the Secretary of the*

## Issues of Supervisory Agency Organization and Procedure

At present, three federal agencies are responsible for overseeing the major GSEs: The Farm Credit Administration (which supervises the Farm Credit System and the Federal Agricultural Mortgage Corporation (Farmer Mac)), the newly-created Federal Housing Finance Board (which oversees the Federal Home Loan Bank System), and the Department of Housing and Urban Development (which oversees the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)). One major GSE, the Student Loan Marketing Association (Sallie Mae), has no overseer.

The general consensus among the various studies of GSEs is that additional oversight of GSE risk-taking and capital levels is needed. With respect to regulatory organization or procedure, the studies recognize the need for a better system of monitoring to ensure that the federal government obtains timely information on the risks undertaken by GSEs. They also urge that each GSE be subject to effective federal supervision, including appropriate enforcement authority, and generally recommend the primacy of safety and soundness regulation over program regulation. Indeed, the General Accounting Office has suggested the centralization of the financial supervision of all enterprises in a single (existing or new) agency.[4]

Although the Conference does not have an opinion on what would constitute the optimum structure,[5] it does feel strongly that however the regulatory authority is organized, the agency or agencies should be given adequate supervisory authority and enforcement tools to do the job. Several of

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*Treasury on Government-Sponsored Enterprises* (May 1990); Treasury Department *Report of the Secretary of the Treasury on Government-Sponsored Enterprises* (April 1991).

[4] 1990 GAO report, *supra* note 2 at 107, and 1991 GAO report at 4, 47-57.

[5] The Conference wishes to emphasize that the GSEs studied are not fungible entities. Each has its own particular characteristics, and any regulatory scheme should be implemented with this in mind.

the studies reference the bank regulatory model as a suitable starting point for designing an effective system of government oversight.[6] If the banking regulatory model were applied, some modifications would be appropriate. Most importantly, for those GSEs with low risk profiles, a less intrusive, more streamlined oversight process would be appropriate--including assessment of management quality and operations risk and use of computerized financial models to examine credit and interest rate risk. Because capital would be adequate and risks low, the supervisory agency would not become involved in management decisions of the GSE.

At least several of the GSEs would seem to be likely candidates for such streamlined oversight. As an institution's risk profile worsened, however, or if factors develop that prevent effective use of this process, then more intensive financial examination might be invoked. If an institution's risk profile worsened even further, then appropriate enforcement powers, including the authority to issue capital directives and cease-and-desist orders, would be available. Similarly, the supervisory agency would have authority to reorganize the affairs of a failing institution and thereby reduce the chance that losses might be compounded.

It would be helpful for the GSEs as well as the public to have a better sense of the applicable supervisory objectives and standards as they develop. Thus, the supervisory agencies should promulgate such guidelines through notice-and-comment rulemaking.

The Conference recognizes that GSEs are undergoing the study and scrutiny their importance warrants. This recommendation is an attempt to add a procedural, comparative framework to executive and legislative proposals for strengthening their oversight.

## RECOMMENDATION

The Conference recommends that the following principles should apply to federal supervision of safety and soundness of government-sponsored enterprises (GSEs):

1. **Institutional Capacity.** Each GSE should be supervised for safety and soundness by a federal agency. Any federal agency responsible for supervising

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[6] See, e.g., the 1990 GAO report, *supra* note 2 at 4, 104, and the 1991 Treasury report, *supra* note 2 at 10. Congress has already provided that the Farm Credit System is supervised by an agency with the institutional capabilities and range of administrative authority and enforcement powers available to bank regulators.

safety and soundness of one or more GSEs should be funded so that it is capable of overseeing the activities of often large institutions involving great numbers of often complex transactions.

2. **Administrative Authority and Enforcement Powers.** A federal agency responsible for supervising GSE safety and soundness should have the express authority to (a) examine financial condition (including collecting such financial information as may be desirable) and risk-taking by the institution, (b) set and enforce effective risk-related and minimum capital requirements, (c) enforce necessary safety and soundness measures with cease-and-desist orders and other enforcement powers available to financial regulators, and (d) reorganize the affairs of a failing institution.

3. **Supervision.** A federal agency responsible for supervising GSE safety and soundness should obtain prompt and timely information and develop and maintain risk ratings of each GSE it supervises. Only if an institution's risk profile is significant should the agency extend its involvement to management issues, as necessary to protect the financial integrity of the GSE.

4. **Promulgation of Guidelines.** A federal agency responsible for supervising GSE safety and soundness should, to the extent feasible, develop guidelines for invoking its supervisory and enforcement powers. These guidelines should be promulgated through notice-and-comment rulemaking.

## Recommendation 91-7

# Implementation of Farmer-Lender Mediation by the Farmers Home Administration

The Farmers Home Administration ("FmHA") is charged with serving as a temporary source of supervised credit and technical support to help rural Americans improve their farming enterprises, housing conditions, and other business endeavors until they are able to qualify for private sector resources. During the 1980s, an economic downturn seriously affected the agricultural sector and led FmHA, as a lender of last resort, to increase its loan portfolio. As the decline continued, FmHA and other lenders began more frequently to exercise their rights to accelerate loans and foreclose. Several midwestern states' legislatures responded to these economic (and resultant social) conditions by creating mediation programs, some of which required financial institutions to mediate prior to foreclosure if the borrower opted to do so. FmHA generally declined to participate in these programs or to restructure loans in connection with mediations.

In 1988, Congress passed the Agricultural Credit Act, a broad attempt to deal with problems related to farm debt. Among other things, the Act sought to encourage lenders to restructure loans when doing so would be in the government's interest and would help keep the farmer on the farm. The Act also provided for matching funds from FmHA for state mediation programs that were certified to meet prescribed standards. It further required FmHA to participate in such state mediation programs, and to make "a reasonable effort" to contact creditors and encourage them to take part in a restructuring plan. In carrying out this last requirement, FmHA has provided that delinquent borrowers in all states will routinely be offered a chance to participate in a voluntary meeting of creditors, chaired either by a mediator or a "designated FmHA representative," and has contracted for mediation services in many states that lacked mediation programs.

FmHA has found this venture into mediation to be cost effective. FmHA's approach to mediation pursuant to the Act has been quite diverse, however. This is due in significant part to differences among the certified state programs, but also to the diversity of approaches among the mediation providers in noncertified states, variations in local conditions, dissimilarities in the attitudes of FmHA state directors towards mediation, and varying enthusiasm of other creditors, including some federal agencies. Given the size and diversity of the farm credit program and the speed with which the Act was implemented, this is hardly surprising. On the whole, the Act's mediation provisions appear to have begun to restore frayed communications between numerous farmers and lenders, assisted many farm families to avoid crises, and avoided foreclosure in a large number of cases. Still, administering these statutory provisions has not been free of problems.

In many cases, mediation has occurred too late to produce successful outcomes. The FmHA, at present, is unable to report accurately on the numbers of mediations conducted in either the certified or noncertified states. As stated above, FmHA has sometimes had difficulty in securing satisfactory participation of non-FmHA creditors, including many that are part of the Farm Credit System, and, in some areas, agencies such as the Federal Deposit Insurance Corporation, Internal Revenue Service, Resolution Trust Corporation, and Small Business Administration. Observers have raised concerns that borrowers in FmHA's loan guarantee programs--in which it guarantees loans made by banks--may not receive timely notice of mediation's availability.

Finally, the mediators used have taken strikingly divergent views of their responsibilities and authority. These might be categorized conveniently as "broad" and "narrow." In some areas--particularly states with certified mediation programs--many mediators have taken a "broad" approach and sought to uncover the parties' real interests and develop responsive options. Thus, they have tried to lower barriers to communication and to address issues, such as off-farm employment and intra-family or interpersonal questions, important to the resolution of difficulties between the farmer and lenders. In other regions, especially some states where FmHA has contracted for mediation services, neutrals have typically taken a "narrow" approach; this emphasizes much shorter, more formulaic proceedings that focus almost exclusively on whether non-FmHA creditors will adjust their debts sufficiently to permit FmHA loan restructuring under its Debt and Loan Restructuring System computer program (DALR$). Resort to the latter approach to mediation may have been reinforced in some places by contracting procedures that emphasized low bids and by some FmHA state directors' narrow view of their mandates for restructuring under the Act. Each of these approaches has potential advantages and disadvantages and FmHA's openness to both is understandable, especially given that FmHA's resort to mediation in all but the certified states has been wholly voluntary. However, broader approaches are more likely to improve communication and assist the parties to develop diverse solutions that will meet their needs.

While FmHA's implementation of the Agricultural Credit Act's farmer-lender mediation provisions has been energetic and generally effective, the

Conference recommends several steps to enhance the likelihood that mediation will be used, and used successfully, in future disputes.

## RECOMMENDATION

1. FmHA should take steps to remedy problems associated with the inconsistencies between the broad and narrow approaches to mediation evidenced in farmer-lender mediation by fostering a better understanding of the potential of the broad model of mediation in both certified state mediation programs and FmHA contract mediation programs. To achieve that goal, the FmHA should:

    (a) Modify FmHA rules for processing delinquent loans to the extent necessary to give FmHA representatives at farmer-lender mediations greater discretion with respect to loan restructuring and providing new loans. FmHA should advise its personnel, mediators, and others involved in farmer-lender mediation that the Debt and Loan Restructuring System (DALR$) computer program should not significantly limit the purposes of mediation. FmHA also should encourage its county offices to initiate mediation proceedings at an appropriately early stage in the processing of delinquent loans.

    (b) Provide additional training, including videotapes, to FmHA and other personnel who will be connected with farmer-lender mediation processes. Training should include approaches to mediation and emphasize problem-solving negotiation skills.

2. FmHA should enhance its ability to manage and improve the farmer-lender mediation program by:

    (a) Ensuring that certified state mediation programs make timely, uniform submissions concerning numbers and results of mediations.

    (b) Improving the system by which FmHA collects information on mediations conducted through FmHA state offices in noncertified states.

    (c) Supporting research dealing with the conduct and short- and long-term outcomes of farmer-lender mediations. This research should examine economic outcomes, the extent to which mediators follow different mediation approaches in practice, and the extent to which varying approaches, as practiced, result in different kinds of outcomes, levels of participation, or levels of satisfaction among the various participants.

3. FmHA should take appropriate measures to notify parties to guaranteed (as opposed to direct) loans of the availability of farmer-lender mediation, without however revealing the borrowers' identities without their consent.

4. FmHA and the Department of Agriculture should:
   (a) Continue to encourage additional states to develop farmer-lender mediation programs that can qualify to receive matching funds.
   (b) Encourage full participation in farmer-lender mediation by institutions of the Farm Credit System and all appropriate agencies of the Department.
   (c) Take steps to encourage the continuing development of a diverse, capable cadre of available mediators, including the use of volunteers.

5. All federal agencies that may be involved in farm credit disputes, such as the Federal Deposit Insurance Corporation, the Internal Revenue Service, the Resolution Trust Corporation, and the Small Business Administration, should consider the overall advantages of broad participation in farmer-lender mediation.

## Recommendation 91-8

# Adjudication of Civil Penalties Under the Federal Aviation Act

The Federal Aviation Administration is currently operating a demonstration civil penalty program under which the FAA may impose monetary penalties of up to $50,000 for violations of the Federal Aviation Act or its regulations. Under the program, the FAA prosecutes violations, proposing initial civil money penalties according to the discretion of the prosecuting FAA official. The persons on whom the penalties would be imposed, usually pilots, air carriers, mechanics, or airport operators, are entitled to an administrative hearing before an administrative law judge at the Department of Transportation, followed by the right to an administrative appeal to the administrator of the FAA. Judicial review is available in the federal courts of appeals.

Before the demonstration civil penalty program was enacted in 1987, the FAA could propose civil money penalties, but such penalties could be imposed only through a civil action brought in a United States District Court through Justice Department attorneys.

The Federal Aviation Act also provides that violations of the Act or the regulations may result in suspensions or revocations of certificates of pilots, mechanics or air carriers. These cases follow a different administrative path. While "certificate actions" begin with a prosecutorial decision made by an FAA official, exercising the right to a hearing takes the case to the National Transportation Safety Board, an independent agency. If a hearing is requested, an NTSB ALJ holds the hearing, with a right to appeal to the Board. Judicial review is available in the federal courts of appeals.

In 1990, the Administrative Conference of the United States, in Recommendation 90-1, "Civil Money Penalties for Federal Aviation Violations," recommended that the FAA administrative civil money penalty program be made permanent, that the $50,000 ceiling on administratively-imposed penalties be eliminated, and that the responsibility for adjudication be studied further. In response to the Conference's Recommendation 90-1, Congress extended the program for an additional 2 years. In that legislation, Pub. L. No. 101-370, Congress expressly asked the Conference to study and make a recommendation on the issue of "whether the authority to adjudicate administrative complaints under the Federal Aviation Act of 1958 should remain with the Department of Transportation, should be transferred to the NTSB, or should be otherwise modified."

## DISCUSSION

Preliminarily, the Conference reiterates its previous recommendation that the civil money penalty program be made permanent and that the $50,000 ceiling on administratively-imposed penalties be removed.

The issues relating to how civil penalties should be adjudicated in the context of this program are controversial. There is no objectively correct resolution; nor do administrative law principles clearly lead to any single solution. Among the various (and not easily resolvable) concerns that arise in this context are:

- The regulated community has concerns about the fairness of FAA's administration of the civil money penalty program, resulting from the fact that appeals of civil penalty cases are heard by the FAA Administrator. The consultant's study, however, found no evidence of actual unfairness or mishandling of cases resulting from commingling prosecutorial and judging functions under the present system.
- The FAA is distinctive in its exercise of operational responsibility for the air traffic control system, which makes it a co-actor with persons or entities subject to its regulatory jurisdiction. The consultant's report noted a continuing perception that there is a conflict of interest between FAA as final adjudicator and its role as overseer of the air traffic control system.
- There is concern that cases based on similar facts being heard in two different agencies could have the potential for inconsistent standards and lead to forum shopping between the FAA civil money penalty program and the NTSB certificate revocation remedy.
- The FAA Administrator, as the Secretary of Transportation's delegate, is the chief policymaker in the area of air safety, and is charged with the responsibility for the safety of the national aviation system. The Administrator therefore has a legitimate interest in having some control over a related enforcement program.
- The NTSB, in its role of recommending air safety improvements, benefits from its review of enforcement cases, as an opportunity to learn about potential safety problems in a context other than an accident investigation.

The best resolution of the controversies associated with civil penalty adjudication authority would be a consensual one, satisfying the legitimate concerns of the FAA and the reasonable needs of all of the affected interests.[1] The Conference encourages the FAA Administrator and the NTSB Chairman to convene and jointly host a conference with representatives of affected public and private interests to consider negotiating solutions for allocating adjudicatory authority over the civil money penalty and certificate revocation and suspension programs. The Conference is available to assist as appropriate. If such a mutually agreeable resolution is developed in the future, the Conference's Committee on Adjudication is available to provide comments to Congress on the proposed solution.

Because the success of an aviation safety program ultimately rests on voluntary compliance, improving the relationships among the regulated communities, public representatives and the government agencies is crucial. Representatives of the FAA and NTSB indicate that the relationship between the two agencies is a cooperative one. To further this cooperative spirit, the Conference recommends that, in addition to meeting to discuss the specific issues of allocating adjudicatory authority for the civil money penalty and certificate programs, the FAA and NTSB should encourage long-term proposals for ways to enhance compliance and enforcement of the Act, through discussions and communication with the regulated community and the traveling public.

In the absence of a consensual resolution on the issue of where adjudicatory authority for FAA enforcement cases should reside, the Conference recommends that adjudicatory authority over a small percentage of selected civil money penalty cases (those involving pilots and flight engineers) be transferred to the NTSB. This recommended solution would address several problems. It would locate both civil money penalty and certificate authority for these cases in one forum, eliminating the potential for forum shopping as to pilots and flight engineers. It would eliminate perceived conflicts of interest as to those classes of cases in which conflict is most likely between FAA employees with operational responsibility for air traffic control and persons subject to civil penalty authority (i.e., pilots and flight engineers). While the unitary enforcement (rather than the split enforcement) model is used in almost all administrative civil money penalty programs, the FAA's distinctive role in administering the air traffic control system is a sufficiently special characteristic to provide plausible justification for recommending this limited expansion of the existing split-enforcement model in this context.

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[1] The Conference held a public hearing on Wednesday, June 19, 1991, to provide interested parties with the opportunity to present their views on these issues. 56 Fed. Reg. 22693 (May 16, 1991) (notice of Conference Committee on Adjudication public hearing). After the Conference consultant released his draft report, he convened an informal meeting with affected parties to explore the feasibility of a solution to the controversy that accommodates the reasonable needs of all of the affected interests. Participants in that meeting agreed that informal consultation was desirable and the consultant met further with representatives of the affected interests to discuss alternatives. While no overall resolution was agreed to, the willingness to seek common ground was enhanced.

This recommendation to use a split-enforcement model in this particular situation is not to be read as a general endorsement of this model for other government programs. Rather, it reflects the specific circumstances involved here, including the fact that the split-enforcement model is already in use in certificate cases, and that the FAA has a significant operational role in air traffic control that may result in potential conflicts of interest in cases involving pilots or flight engineers.

Removing pilot and flight engineer cases from the FAA also conflicts the least with comprehensive exercise of FAA safety policy authority, given the individual character of most violations involved in these cases. Conversely, retaining civil penalty authority at the FAA for nonpilot and nonengineer cases, which constitute more than 75 percent of the civil money penalty cases, presents less potential for conflict between respondent interests and the FAA's air traffic control responsibility. There is also greater likelihood that the problems exposed by civil penalty actions in air carrier, airport security and hazardous materials cases are more systemic in nature.

For those cases within the Board's authority, the Conference is making additional recommendations. First, because a split-enforcement model involves one agency ruling on the actions of another, the Act should address the issue of the appropriate level of deference that should be given in enforcement cases to the FAA's interpretations of its rules. The Conference recommends that validly adopted FAA interpretations of FAA regulations be deferred to, unless such interpretations are arbitrary, capricious or not in accordance with law. This recommendation is consistent with Recommendation 86-4, "The Split-Enforcement Model for Agency Enforcement." See also *Martin v. Occupational Safety and Health Review Commission*, _ U.S. _; 111 S. Ct. 1171 (1991). This does not, however, mean that NTSB should simply defer to litigation positions of the FAA prosecutor. Id. at 1179. In addition, the FAA should be given the authority to appeal to the Board from adverse NTSB decisions at the administrative law judge level and to seek judicial review in the appropriate court of appeals from decisions of the Board. The FAA is still the chief policy making agency in the area of aviation safety, and should have the ability to challenge decisions it believes are inconsistent with those policies.

The merger of sanction authority over pilots and flight engineers in one forum should provide the NTSB with increased flexibility to select the appropriate sanction from the range of available sanctions. However, such flexibility must operate within the bounds of FAA's validly adopted standards and criteria for sanctions. Such criteria may, as with all rules, be adopted through the appropriate rulemaking procedures or through adjudications.[2] In addition, a potential respondent must be on notice of the range of potential sanctions for which he or she potentially would be liable.

The Conference also encourages greater use of a variety of dispute resolution techniques in individual cases. The Administrative Dispute Resolution Act, Pub. L. No. 101-552, encourages agencies to use such techniques where appropriate. The growing body of alternative dispute resolution literature supports the view that efficiency gains for everyone are available from flexible means of resolving disputes. Such flexibility might be useful in a variety of contexts in civil money penalty and certificate cases. The Conference specifically recommends consideration of the utility of settlement judge procedures.[3]

## RECOMMENDATION

1. Congress should make permanent the civil money penalty program for violations of the Federal Aviation Act (the Act) and eliminate the $50,000 ceiling on administratively-imposed penalties.[4]

2. The question of where adjudicatory authority over certification and civil money penalty proceedings under the Act should be placed raises complicated policy as well as legal issues. Principles of administrative law provide no single clear answer. The Federal Aviation Administration Administrator and the Chairman of the National Transportation Safety Board jointly should convene a conference with representatives of affected interests to consider possible consensual arrangements for allocating adjudicatory authority over the civil money penalty and certificate suspension and revocation programs. The FAA and the NTSB should also encourage long-term proposals for enhancing compliance and enforcement of the Act, and for changing the procedures to achieve the Act's objectives.

3. In the absence of consensus by the affected agencies and interests as to where the Act's certification and civil money penalty proceedings should be adjudicated, Congress should amend the Act consistent with the following recommendations:

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[2] See SEC v. Chenery, 332 U.S. 194 (1947); NLRB v. Bell Aerospace Co., 416 U.S. 267 (1974).

[3] See Conference Recommendation 88-5, "Agency Use of Settlement Judges," 1 CFR §305.88-5 (1991).

[4] See Conference Recommendation 90-1, "Civil Money Penalties for Federal Aviation Safety Violations," 1 CFR §305.90-1 (1991).

A. Authority for adjudicating civil money penalties against pilots and flight engineers should be transferred from the FAA to the NTSB, with all other civil penalty adjudication authority remaining at the FAA. This recommendation is contingent on Congress' transfer of necessary budgetary resources for this purpose to the NTSB.

B. The Act should provide that, for purposes of review of FAA enforcement actions, courts and the NTSB should defer to validly adopted FAA interpretations of its statutes and regulations, unless it is shown that such interpretations are arbitrary, capricious, or otherwise not in accordance with the law.[5]

C. The FAA should be given the right to appeal an NTSB administrative law judge decision to the Board, and to seek judicial review of a decision of the Board in the appropriate court of appeals.

This recommendation is directed only to this specific program and the special circumstances involved, and should not be read as implying any views as to the merits, generally, of the "split enforcement" model as compared to the "unitary agency" model of adjudication in other government programs.

4. In an NTSB adjudication under the Act, the range of possible sanctions for violations of the Act should include certificate revocation, certificate suspension and/or a monetary penalty, as found by the NTSB to be appropriate and consistent with rules validly adopted by the FAA with respect to applicable standards or criteria for the imposition of sanctions. Notice of possible sanctions, as well as those proposed by the FAA in a particular enforcement matter, should be provided to the respondent upon the institution of the proceeding. The selected sanction(s) should be set forth in the ALJ's initial or recommended decision, together with the bases therefore, including a reference to any applicable FAA standard or criterion for the imposition of sanctions.

5. NTSB and FAA adjudicators, as well as FAA prosecutors, should place greater emphasis on alternative dispute resolution in individual cases. In particular, the FAA and NTSB, to the extent each has adjudicatory responsibility, should consider Recommendation 88-5, "Agency Use of Settlement Judges," and make greater use of the techniques described there.

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[5] See Conference Recommendation 86-4, "The Split-Enforcement Model for Agency Enforcement," 1 CFR §305.86-4 (1991). See also Martin v. OSHRC, _ U.S. _; 111 S. Ct. 1171 (1991). This recommendation should not be read to suggest that deference should automatically be given to FAA prosecutors' litigation positions. Id. at 1179.

# Recommendation 91-9

## Specialized Review of Administrative Action

In recent years, there has been much talk of a crisis in the federal courts. In response, Congress empaneled the Federal Courts Study Committee, charging it with responsibility to examine the problems facing the courts and to develop a long-range plan for addressing them. The Committee issued its report in April 1990, touching on many different aspects of the problem, among them those related to judicial review of administrative action.

The Federal Courts Study Committee specifically rejected a proposal to divert all administrative appeals to a specialized court within the Article III judiciary. The Committee recognized that administrative review cases do not form a major percentage of the caseload of the federal courts of appeals. Yet assigning jurisdiction to a specialized court may provide more efficient or effective review for some types of administrative cases. It, therefore, proposed diversion of some cases now in the Article III courts to other adjudicatory bodies; in particular, the Committee recommended creation of an Article I court to review Social Security disability claims and perhaps, eventually, other administrative benefit claims.

Finding the optimal structure for review of administrative cases involves a complex balancing of various factors: the need for uniform law versus the benefits of "percolation" in the decentralized circuits; the value of expert decisionmakers versus the broader perspective of generalists; the efficiency of specialization versus the risk of bias that specialization entails. And the calculation can vary in the context of different administrative programs, which differ in the volume, complexity, and level of technical content of the caseloads they generate. For these reasons, the Conference, like the Federal Courts Study Committee, opposes allocating review of all administrative cases to a single specialized court, whether inside or outside the Article III system.

Should Congress consider the creation of specialized courts for review of particular administrative programs, this recommendation sets forth criteria for Congress to take into account in determining when to create specialized courts and how to structure them to enhance their effectiveness. Certain characteristics held in common by many federal regulatory and benefit programs raise particular problems within the existing system of judicial review. Uniformity in decisionmaking can be especially important in the context of administrative action under national programs. The agencies themselves are structured hierarchically, so as to speak with a single voice in applying law and policy to individual circumstances. But the federal court system that reviews these agency programs is decentralized, and different circuits often reach different outcomes on the same issue. The Supreme Court's capacity to resolve these conflicts is severely limited by the modest number of administrative law cases it considers each year. As a result, agencies often face the choice of refusing to acquiesce in decisions below the Supreme Court level, abandoning policy positions they believe to be correct, or implementing programs differently in different regions (and, consequently, treating similarly situated individuals or entities differently and encouraging forum shopping).

Another special aspect shared by some federal regulatory programs is that they involve complex technical or scientific issues, which may present great challenges to reviewing courts without special expertise in the relevant areas. Cases on review of agency rulemaking and ratemaking actions, in particular, frequently involve lengthy administrative records filled with conflicting material on technical issues of fact and policy; the judges must devote extra time to poring over these records and to producing the longer opinions these cases often engender.

Other federal programs (such as individual benefit programs) produce masses of litigation involving primarily questions of specific fact. Resolution of these issues may be an inefficient allocation of the time of the federal courts.

While review by specialized courts may offer a solution for these problems, specialization brings dangers as well. One premise of the national system of courts of general jurisdiction is that sound decisionmaking results from exposure to a wide range of problems and issues; adjudicative bodies with limited subject matter jurisdiction may lack this generalist perspective. Specialization can also produce bias problems of two kinds: the appointments process may be distorted as interest group pressures lead to the selection and confirmation of nominees for their views on specific issues; in addition, the standard of review may be distorted, either because expertise leads the court to substitute its judgment for that of the agency or because familiarity with a particular agency leads the court to accept the agency's positions too readily. Public perception that a court is biased can reduce its effectiveness even when actual bias is not present. Finally, a specialized court may suffer reduced prestige if its repetitive subject matter attracts lower caliber judges.

The recommendations that follow offer guidance to Congress on the considerations it should take into account when it deliberates about whether to assign responsibility for review to a specialized court; they should be read as a whole. Thus, for example, the criteria in recommendation 2 may suggest assignment of Social Security disability cases to a specialized court; if Congress considers such an approach, however, it should take into account recommendations 3(B) and 3(C), favoring a balanced docket and a jurisdictional mix. These recommendations are intended to complement Conference Recommendation 75-3, "The Choice of Forum for Judicial Review of Administrative Action," 1 CFR §305.75-3 (1990), which the Conference continues to believe should form the foundation for decisionmaking about the appropriate forum for judicial review of administrative action within the Article III courts.

## RECOMMENDATION

1. When considering proposals for the creation of a specialized court or courts to review administrative action, Congress should take into account that federal agency programs vary greatly in the volume, complexity, and level of technical content of the caseloads they generate, and, thus, any solutions adopted should be designed to fit the specific administrative programs to which they will apply. For these reasons, among others, the Conference opposes the creation or designation of a single specialized court, either within the Article III judiciary or under Article I, to handle review of all administrative cases.

2. Congress should recognize that it is appropriate to create specialized courts for particular administrative programs only if such programs are characterized by the following:

   A. a program area in which one might reasonably expect a consistently large volume of cases, diversion of which might significantly alleviate burdens on the generalist federal courts;

   B. the predominance of factual issues specific to particular cases, or the predominance of scientific or other technical issues requiring special expertise of decisionmakers; and

   C. the particular importance of uniformity in agency administration of a program.

3. If Congress creates specialized courts to review particular administrative programs, it should, to the extent possible, structure the courts as follows:

   A. To minimize jurisdictional uncertainty, the subject matter before the courts should be segregable from other claims.

B. To ensure that the courts maintain a balanced perspective on the issues before them, the courts' dockets should be designed to expose judges to all sides of pertinent controversies and to the broadest possible scope of related issues within a field of law.

C. To encourage generalist judicial appointments, to minimize distortion of the standard of review resulting from loss of the generalist perspective, and to avoid the fact or appearance of capture by special interests, the courts' subject matter jurisdiction should be diverse.

If the court provides the final stage of judicial review before Supreme Court review, satisfaction of criterion C is essential.

4. If Congress creates specialized courts to review particular administrative programs, it should provide for periodic evaluation of those courts to determine whether there is a continuing need for specialized review.

5. In any legislation providing for specialized review of particular administrative programs, Congress should assign to each court or reviewing body the type of functions it is best suited to perform and should minimize duplication of review functions. In particular, any such legislation should:

A. Avoid *de novo* review of factual issues already subject to formal adjudication at the agency.

B. Make the decisions of specialized courts final on review of questions of fact specific to the case (including the sufficiency of the evidence in that case by whatever standard it is reviewed).

C. When review has been assigned to an Article I specialized court, provide a subsequent layer of judicial review by an Article III court for questions of constitutional or statutory interpretation.

# Recommendation 91-10

## Administrative Procedures Used in Antidumping and Countervailing Duty Cases

This recommendation discusses several possible reforms of the administrative procedures used in U.S. antidumping (AD) and countervailing duty (CVD) cases. These cases usually arise when a petition is filed on behalf of a U.S. industry by one of several statutorily specified interested parties asking the U.S. Government to impose special duties to offset dumping or subsidization. The government itself can also initiate cases.

Dumping occurs when foreign companies export goods to the United States for sale at less than their "fair value." Fair value is generally based on the exporter's prices for such goods in its home (or a third country) market or on its cost of producing the goods (including a profit margin). AD duties are imposed to offset the margin of dumping (i.e., the difference between the foreign market value and the U.S. price) if the U.S. industry producing like goods has suffered or is threatened with material injury by reason of the dumped imports, or if the establishment of a U.S. industry producing such goods has been materially retarded.

Countervailing duties may be imposed on goods exported to the United States that benefit from certain types of subsidies granted by a foreign government. In most CVD cases, duties may be imposed only if the U.S. industry producing like goods has suffered or is threatened with material injury by reason of the dumped imports, or if the establishment of a U.S. industry producing such goods has been materially retarded.

The decision whether dumping or subsidization has occurred is made by the International Trade Administration (ITA) of the Department of Commerce; the decision on injury is made by the U.S. International Trade Commission (ITC). These administrative decisions are subject to review, in the first instance, in the Court of International Trade, and then in the Court of Appeals for the Federal Circuit. In the case of Canadian exports, the decisions may be "appealed" instead to a binational panel established under the U.S.-Canada Free Trade Agreement.

In recent years, the use by the United States and other countries of AD and CVD laws has been controversial. While many of the complaints about these laws are essentially about their substantive provisions, a number of the complaints concern procedural matters. In particular, some critics have contended that the high cost of defending these cases, which are often quite complex proceedings involving the collection and analysis of vast amounts of data and that often continue for years, amounts to a new form of protectionism--process or procedural protectionism. At the same time, U.S. domestic producers complain that the great expense of invoking these laws virtually precludes their use by some petitioners deserving of relief.

The two concerns that seem to be foremost in the minds of trade law practitioners are reducing the time and expense associated with AD and CVD proceedings and improving the decisionmaking process under the relevant statutes. The Conference notes, at the outset, that the complex procedures for AD and CVD cases, involving a division of responsibilities between two agencies with appeals to a specialized court and then to a federal court of appeals, may contribute to the time and expense associated with these proceedings. The Conference recommends in Part A that Congress authorize and fund a study of the agency structures and judicial review for AD and CVD cases. Recommendations B, C and D are intended to address problems arising under the current structure.[1]

The ITA and ITC both view AD/CVD proceedings as investigative rather than adjudicatory. Nonetheless, given the conflicting positions of the parties before the agencies--the domestic industry versus the foreign exporters--and their role in supplying much of the information on which the agency decisions are based, the parties do and should play an important part in the process. That part could be made more useful if hearings at which the factual submissions of the two sides are tested could be conducted more effectively than at present.

In the case of the ITA, the hearing officer typically does not participate in the hearing or engage in interchanges with counsel. The ITA hearing process would be improved if the hearing officer were more knowledgeable about the contested issues and participated more actively in interchanges with counsel than is presently the case.

In the case of the ITC, hearing times for cases are standardized and somewhat inflexible, even though cases vary widely in complexity and number of parties, with the result that in some cases parties have only a few minutes for oral presentations. Testing of factual information at the hearing is limited by practices that discourage cross-examination of witnesses. The ITC hearing process would be improved if, in setting the times for oral presentations, the ITC took into account factors such as the complexity of the case and the number of parties involved. The ITC should also allow reasonable time for cross-examination without subtracting such time from the questioner's time for affirmative presentation.

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[1] In 1973, the Conference recommended a number of reforms in the then existing procedures for administering AD cases. See Conference Recommendation 73-4, "Administration of the Antidumping Law by the Department of the Treasury," 39 Fed. Reg. 4846 (1974). In 1984, it recommended reform of one narrow aspect of AD and CVD procedures--the availability of confidential information under protective order in ITC proceedings. See Conference Recommendation 84-6, "Disclosure of Confidential Information Under Protective Order in International Trade Commission Proceedings," 1 CFR §305.84-6 (1991).

Several changes could be made to simplify ITA administrative procedures and reduce somewhat the time and expense associated with AD/CVD cases. First, preparing the administrative record more promptly would speed up the appeals of cases. Second, streamlining and standardizing the ITA's procedures for handling routine requests for access to information would reduce the amount of time spent by the parties in preparing such requests, thereby reducing costs. The ITA should also strive to reduce parties' costs by reducing where possible the number of copies of documents required to be filed.

Third, the ITA now sometimes decides to reject a party's factual submissions or to change significantly its methodology for calculating dumping/subsidy margins without notice to the parties. It would be desirable for the ITA to notify the parties when it makes such a decision, so that the parties will not continue to prepare their cases on the assumption that the agency has not taken such actions. Implementation of this recommendation would allow parties to argue their positions more effectively and avoid wasted effort. This recommendation is not intended to suggest that the ITA does not have the right to reject a party's evidentiary submissions, or that a party should have any new rights to more time to comply with ITA information requests or to object to methodology changes. The ITA should also consider whether there are methods within the statutory time constraints to permit parties to comment in response to substantial changes in methodology.

Fourth, at present there are a number of inconsistencies between the way that the ITA's investigations office (which handles the initial investigation to determine whether a AD/CVD order should be issued) and the ITA's compliance office (which reviews shipments made after the issuance of an AD/CVD order to assess the amount of duties owing) handle certain issues. The ITA ought to eliminate those inconsistencies for which there is no justification.

Fifth, under U.S. law the actual amount of AD/CVD duties owed is usually determined after the fact. Exporters deposit an estimated duty when goods are imported into the United States, and that amount may be adjusted upwards or downwards as a result of an annual review, if requested. (If not requested by anyone, the estimated duties are considered to have been collected as the final duties.) The ITA has traditionally had a large backlog of annual reviews, although the backlog has been reduced in recent years, and reduced substantially in recent months. The delay in finally determining duties owed is unnecessarily disruptive to trade flows and unfair to the parties to such cases. Accordingly, the ITA should continue its efforts to eliminate its backlog of annual reviews.

The Commissioners of the ITC apparently do not normally meet as a group to discuss their views of a case before their formal deliberations, evidently because of concerns stemming from the Government in the Sunshine Act. It appears that the Commission's reluctance to meet as a group adversely affects the ITC decisionmaking process. The Commission's general counsel has taken the position that its meetings to dispose of AD/CVD cases are not within the terms of exemption 10 of the Act, which exempts meetings involving determinations "on the record after opportunity for a hearing." Some practitioners, however, believe that exemption 10 applies, and the Commission should decide whether such meetings do or should come within the ambit of exemption 10. If the Commission concludes that the meetings in question are not in fact exempted from the Sunshine Act, then Congress should consider exempting such meetings for AD/CVD cases from the Act. As an interim measure for achieving the benefits of collegial decisionmaking, the ITC should take steps to exchange drafts, views and other information among the commissioners before entering into formal deliberations.

## RECOMMENDATION

### A. Congressional Study

The Congress should authorize and fund a study, by the Conference or another appropriate agency, of the agency structures for handling AD/CVD cases. The study should address whether responsibility for these cases should continue to be divided between the ITA and the ITC. It should also consider whether the usual procedure for judicial review of agency adjudications should be followed for AD/CVD cases by providing for direct appeals from the ITA and/or ITC to the Court of Appeals for the Federal Circuit, or whether the additional level of specialized court review at the Court of International Trade is required in these cases.[2]

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[2] The Conference has generally recommended that appeals from administrative agencies should be to the courts of appeals. See Conference Recommendation 75-3, "The Choice of Forum for Judicial Review of Administrative Action," 1 CFR §305.75-3 (1991).

### B. Improved Agency Factfinding Procedures

The ITA and the ITC should develop factfinding procedures that improve development of the administrative record, with increased opportunities for the parties and decisionmakers to test the factual submissions made in the proceedings.

#### 1. ITA Procedures

To accomplish this goal, the hearing conducted by the ITA at the end of its investigation should be presided over by a senior official, with adequate staff support, who is knowledgeable about the contested issues in the proceeding and who actively participates in interchanges with counsel for the parties. Where appropriate, the hearing officer should make a recommendation with regard to the issues raised in the hearing.

#### 2. ITC Procedures

To accomplish this goal, the ITC should provide adequate time for oral presentations, taking into account factors, such as multiple parties or countries under investigation, that may justify more time than normally allowed. The ITC should allow reasonable time for cross-examination in appropriate cases without reducing the cross-examiner's time for affirmative presentation at the hearing.

### C. ITA Administrative Reforms

To improve the efficiency of case processing, the ITA should adopt the following reforms:

1. To speed judicial review, the ITA should complete the record in individual cases and make that record available to parties promptly.
2. The ITA should streamline its handling of applications for release of information under administrative protective orders and of requests for access to computerized information. It should also require that only a reasonable number of copies of documents be submitted by parties.
3. The ITA should give notice to parties before it (a) rejects portions of parties' evidentiary submissions or (b) adopts significant changes in methodology on which the parties have not had an opportunity to comment. The ITA should also consider whether there are techniques within the statutory time constraints to permit parties to comment in response to substantial changes in methodology.
4. The ITA should eliminate unjustified inconsistencies in the practices and policies of its investigations and compliance offices.
5. The ITA should continue its efforts to eliminate its backlog of annual reviews of the actual duties owed by specific companies subject to AD/CVD orders.

D. The ITC and the Government in the Sunshine Act

To encourage collegial decisionmaking, the ITC should exchange drafts, views and other information before entering into formal deliberations. The Commission should decide whether informal meetings to discuss the disposition of AD/CVD cases constitute meetings exempt from the Sunshine Act under exemption 10. If the Commission determines that such meetings are subject to the Sunshine Act, then Congress should consider amending the Tariff Act to provide that the Sunshine Act does not apply to informal meetings held to discuss the disposition of AD/CVD cases.

# REPORTS FOR RECOMMENDATIONS 91-1 THROUGH 91-10

## Report for Recommendation 91-1

# Regulatory Cooperation with Counterpart Agencies Abroad: The FAA's Aircraft Certification Experience

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This report was prepared for the consideration of the Administrative Conference of the United States. The views expressed are those of the author and do not necessarily reflect those of the members of the Conference or its committees except where formal recommendations of the Conference are cited.

# I. Introduction

The character and pace of world developments suggest that if American administrative agencies ever could afford to engage in regulatory policy without regard to the policies and practices of administrative agencies abroad, that era has come to a close. The substantive problems facing the agencies have parallels, to a greater or lesser extent, in the problems facing those agencies' counterparts in foreign countries. It is entirely possible that the policies and procedures developed by governments abroad may be of interest and benefit to American regulators, and that those developed here, one would hope, may be of utility abroad.

The case for international regulatory cooperation does not, however, rest entirely on the exchange of information about the current regulatory landscape. As the experience of certain agencies engaged in international regulatory dialogue demonstrates, there still remain regulatory problems to be identified and solutions, both to new and existing problems, to be found. Particularly in areas of fast-changing technology or fast-evolving standards and expectations, regulatory bodies may find that they actually need, or could profitably share, the resources of other governments in addressing common problems. In their continuous efforts at improving their performance, the agencies have become increasingly aware that contemporary regulation entails a powerful research and development burden whose sharing may be in all regulators' best interests.[1]

However substantial (though still largely unrealized) may be the agencies' interest in regulatory cooperation with foreign counterparts, that interest is at least matched by the prospective advantage of such cooperation to regulated interests and to those affected by those interests. Economic interests generally prefer an orderly regulatory environment with a high degree of correspondence, if not uniformity, among the standards imposed upon them by public authorities in the various markets they serve. The internationalization of business has put the need for that kind of environment on an international scale. It accordingly points in the direction of greater and more deliberate intergovernmentalism in regulatory matters than one generally associates with the American administrative process.

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[1] The FAA has acknowledged economies in research and development costs as a principal reason for its establishment with the European Joint Aviation Authorities of a Joint Cabin Safety Research Group for purposes of shared technological research and development. See Conclusions and Actions of the Open Session of the 6th FAA-JAA Meeting, Bordeaux, France (June 1989); Minutes of 6th FAA-JAA Meeting, Bordeaux, France (June 1989), item VIb.

I have knowingly chosen the general term cooperation to denote the kind of intergovernmentalism described in this report. But it should be obvious that cooperation can take a wide variety of forms, from the casual and unsystematic sharing of information, at one extreme, to a firm commitment to concerted regulatory action, at the other. In between fall a number of different patterns, such as regular consultations, reciprocal participation in foreign agency rulemaking, and various forms of joint study, research and rule development.

However slight may be its present development, international regulatory cooperation is not an entirely new phenomenon. We have long known the existence of international organizations charged with harmonizing or at least developing minimum standards in different regulatory fields. Bilateral and multilateral treaties have formalized international cooperation, and in some instances established common standards. International technical standards bodies do exist, and when their products are adopted as national standards, they too foster a more orderly regulatory environment. The fact remains, however, that a very small fraction of overall American regulatory activity is governed by such formal structures and arrangements and, even where it is, it is rarely governed by them comprehensively.

If the extent of commonality in regulatory problems is as great as it appears to be, and if the private interest in an orderly world-wide regulatory environment is so pronounced, then international regulatory cooperation may call for wider and more consistent practice than it now receives. In fact, in its natural allusion to rulemaking activity, the term regulatory cooperation may understate the potential scope for intergovernmentalism in administrative action. Much of the administrative process looks little like rulemaking or standard-setting. Many observers have pointed out that routine agency conduct, daily administration and individual decisionmaking constitute the bulk of that process, and intergovernmentalism may have a distinct though less easily recognizable role to play in those forms of activity as well.

This report examines in some detail the practice and experience of one agency, the Federal Aviation Administration, and more particularly its Aircraft Certification Service, that has of recent years consciously engaged in forms of concerted activity with certain counterpart agencies abroad. This "case study" is of particular interest because the FAA's practice of intergovernmentalism includes, but also goes beyond, cooperation in rulemaking to embrace a certain amount of cooperation in more routine aspects of administration. The study is also interesting because the intergovernmentalism engaged in largely involves cooperation with a body--the European Joint Aviation Authorities--that is itself an illustration of highly concerted regulatory activity among the component European states, and therefore a model of sorts that may or may not be appropriate for consideration by certain American agencies in certain domains.

This report is largely descriptive of the FAA's interaction with counterpart agencies and of the respects in which that interaction has been thought to facilitate the agency's task and to improve its performance of functions. However, the report will also call attention to certain difficulties and complications that the process has generated, and on occasion point out what might loosely be called lessons learned. Lastly, and appropriately for an Administrative Conference report, it briefly considers the legal constraints, if any, on the kind of intergovernmentalism that the FAA practices and that other agencies may find an interest in exploring.

## II. The FAA's Regulatory Framework For a Airworthiness Certification

Aircraft safety regulation began in the United States in 1926 with passage of the Air Commerce Act. That legislation was superseded in 1938 by the Civil Aeronautics Act and in 1958 by the Federal Aviation Act. The latter, codified at 49 U.S.C. §1000 et seq., represents the current legal framework for regulation of aircraft. The Federal Aviation Act, like its predecessors, is predicated on the need for a safe civil aviation system--one that can enhance public safety and at the same time promote the development of aviation through enhanced public confidence in the system. The Act directs the Federal Aviation Administration (FAA) to conduct "[t]he regulation of air commerce in such manner as to best promote its development and safety."[2] To this end, the FAA has created and maintained an Aircraft Certification Service (the organization chart of which is appended to this report as annex A) whose view and whose raison d'etre are that both aviation safety and public confidence in aviation safety presuppose safe aircraft.[3]

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[2] Federal Aviation Act, sec. 103(a), 49 U.S.C. §1303 (a). The Airline Deregulation Act of 1978, amending Federal Aviation Act, sec. 102 (a)(2), declared that deregulation should result in no diminution of air safety standards.

The Supreme Court, in the context of holding that the FAA is shielded by the Federal Tort Claims Act's "discretionary function" exemption from tort liability for alleged negligence in certificating commercial aircraft, emphasized that the agency "has a statutory duty to promote safety in air transportation, not to insure it." United States v. S.A. Empresa de Viacao Aerea Rio Grandense (Varig Airlines), 467 U.S. 797, 821 (1984) (emphasis in original).

[3] Opening remarks of M. Craig Beard, Director of the Aircraft Certification Service of the Federal Aviation Administration, at the 1989 Annual Conference of the ABA Forum on Air and Space Law, p. 1.

According to the FAA's Regulatory Handbook, aviation safety is the principal objective of the agency's regulatory activity. FAA Order 2100, FAA Regulatory Handbook §1-2 (March 1990) (hereinafter "FAA Regulatory Handbook"). On the other hand, the FAA asserts that "the

## A. Registration and Certification

The airworthiness regulation of individual aircraft is based upon two closely related ideas: registration and certification. The Federal Aviation Act requires that all aircraft operated in the United States be registered if eligible for registration. The obligation to register falls upon the aircraft's owner. Aircraft eligible for registration include those that are *both* (A) owned by an American citizen, permanent resident alien, or (if the aircraft is based and primarily used here) by a corporation doing business under the laws of the United States or any state, *and* (B) not registered under the laws of a foreign country.[4] Thus, if an aircraft is registered abroad, it does not need to be registered in the United States, nor may it be. Within limits, then, owners of aircraft may have a choice from among several jurisdictions in which to register the aircraft. In making that choice, owners usually prefer the country where they reside or conduct their business. As for the United States as place of registry, the Federal Aviation Act positively requires the Secretary of Transportation to issue a certificate of registration to the owner of any aircraft eligible for American registration who requests it.

As a practical matter, aircraft registration as such has limited significance. Registration basically confers upon an aircraft a kind of nationality and serves as conclusive evidence of that nationality. It also gives the aircraft a unique identification number, much as automobile registration specifically identifies a motor vehicle. On the other hand, American law expressly provides that registration is not evidence of ownership of an aircraft in any proceeding in which that matter might be in issue.[5]

Aircraft registration derives its importance chiefly from the certification process to which it is linked. The Federal Aviation Act requires that any civil aircraft registered in the United States have a valid airworthiness certificate before it may lawfully be operated. The aircraft also must conform to the terms of that certificate.[6] Accordingly, certification rather than registration most directly serves the government's interest in aviation safety.

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public interest is not served if standards and regulations go beyond the needs of safety, efficient use of the airspace, national defense, and the general public interest." *Id.* §1-4b.

[4] Federal Aviation Act, sec. 501 (a), (b).

[5] Id., sec. 501 (f).

[6] Id., sec. 610 (a) (1), 72 Stat. 776, 49 U.S.C. sec. 1430. The section makes it unlawful "[f]or any person to operate in air commerce any civil aircraft for which there is not currently in effect an airworthiness certificate, or in violation of the terms of any such certificate." Parallel provisions of section 310 require certification (and compliance with certification terms) of airmen, operating air carriers, aircraft producers and airport operators.

Although certification is the procedure by which the FAA determines the safety of individual aircraft, certification itself actually occurs rather late in the regulatory process. For an aircraft to receive an airworthiness certificate, it first must be shown to conform to an aircraft type design that itself has been certified by the Federal Aviation Administration. The FAA also issues certificates of approval for aircraft production quality control systems, though these (unlike type design certificates) are not strictly speaking prerequisites to the issuance of airworthiness certificates. All three kinds of certificates--design, production and airworthiness--are expressly contemplated in the Federal Aviation Act.[7] In point of fact, the FAA regulates the design and manufacture not only of complete aircraft, but also of certain aircraft appliances and component parts it considers eligible for separate certification. Aircraft and aircraft components are referred to collectively for these purposes as "civil aeronautical products."[8] In addition, the FAA separately licenses pilots, aircraft mechanics, repair stations and the like.

## B. Airworthiness Regulations

If airworthiness certification takes place against the backdrop of prior design and production certification, the latter two kinds of certification in turn proceed on the basis of previously adopted FAA design and production regulations. Put differently, the FAA ensures the airworthiness of U.S.-registered aircraft first by adopting safety regulations on aircraft design and production, then by certifying particular designs and production quality control methods as in compliance with those regulations, and finally by certifying that individual aircraft conform to a certified design and certified production process. The basic standards are found in Title 14 of the Code of Federal Regulations in the form of Federal Aviation Regulations (FARs), organized by various categories of aircraft design in FARs 21 through 35. The regulations governing design and production, like airworthiness standards themselves, are generally the products of traditional administrative rulemaking under the

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In addition, when a non U.S.-registered aircraft is to be operated in the U.S. under lease or charter by a U.S.-certificated air carrier, the aircraft will require an FAA airworthiness certificate. FAA Advisory Circular No. AC 21-23, at 21.

[7] Federal Aviation Act, sec. 603 (a), (b), (c), 49 U.S.C. §1423 (a), (b), (c).

[8] A civil aeronautical product is defined as "any civil aircraft, or aircraft engine, propeller, appliance, material, part, or component to be installed thereon." Advisory Circular No. AC 21-23, p.ii.

Administrative Procedure Act.[9] On the other hand, the airworthiness certification of civil aeronautical products is a species of individual administrative decisionmaking. Part III of this report more fully presents the regulatory process just described, but from the regulated industry's point of view.

## C. Compliance and Enforcement in Aircraft Certification Matters

Naturally, the FAA's involvement in air safety issues does not end with initial airworthiness certification of an aircraft or component. The agency has established programs to monitor the safety performance of aircraft in service and to direct corrective actions on the part of manufacturers, owners and operators if unsafe situations are later deemed to arise. Regulations known as Airworthiness Directives (ADs) may be issued to require design modifications, special inspections or special operating procedures, or to define new operational limitations for aircraft.

The FAA also has need of a mechanism for dealing with eventual noncompliance with civil aviation standards on any of the matters covered by the FAA certification procedures, that is to say, for enforcement. If noncompliance is detected prior to the issuance of the relevant certificate, then the result will be denial of the certificate. Failure to comply with the terms of a certificate once issued, on the other hand, may result in a range of administrative sanctions, including revocation of the relevant certificate. Internal FAA guidelines seek to channel the agency's discretion in determining the appropriate sanction for any such violation.[10]

The FAA enforcement program applies equally to all activities regulated by the agency. When violations occur--whether involving the production or maintenance of aircraft (the subject matter of the certification upon which this report focuses) or the operation of airports or of aircraft--enforcement action may be indicated. Internal FAA guidelines describe the processes of surveillance, investigation, reporting and referral of matters for appropriate enforcement action.[11] These activities are understandably directed primarily at manufacturers so far as the production of aircraft is concerned and at air carriers with respect to aircraft maintenance. Actions on other matters will be directed toward certificated maintenance personnel, certificated maintenance facilities (known as "repair stations") and even aircraft operators if they operate an aircraft in noncompliance with an airworthiness directive.

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[9] Section 601 (a) gives the FAA Administrator authority to promulgate minimum airworthiness standards for aircraft and component parts.

[10] See FAA Order 2150.3A, Compliance and Enforcement Program (Dec. 14, 1988).

[11] *Id.*

Details of the FAA's compliance and enforcement program lie outside the scope of this study and will not be further examined in the chapters that follow. Suffice it to say that an airworthiness inspector who finds an aircraft not to be in condition for safe operation must promptly notify the aircraft owner or operator and report to the agency. The subsequent factual investigation yields a violation report. The same would be true, for example, of allegations that an aircraft manufacturer failed to maintain a quality control system during aircraft production. FAA guidelines urge both careful adherence to regulations and attention to mitigating or otherwise unusual circumstances ("firmness" and "fairness").[12] However, air carriers appear, in keeping with section 601(b) of the Federal Aviation Act, to be held to an especially high standard, namely "to perform their services with the highest possible degree of safety in the public interest."

Enforcement, with a view to promoting compliance with the established safety standards, is achieved through both informal administrative action (warning letters or letters of correction) and formal legal action. Statutory methods for the latter include amendment, suspension and revocation of certificates (FAA sec. 609), civil and criminal penalties (FAA secs. 901-02), and aircraft seizures (FAA sec. 903), supported by judicially enforceable orders, including cease and desist orders and injunctions (sec. 1007). Considerable emphasis is placed by the FAA on guidelines for choosing between administrative and legal enforcement action,[13] and, within the latter, for the exercise of discretion in sanction-setting.[14] The FAA states as a matter of principle that a legal sanction should be selected in each case that is sufficient to punish the particular violation, and to serve as a deterrent and example to others. At the same time, settlement may be entered into when it will avoid unnecessary litigation and is warranted by the facts.

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[12] *Id.* p. 14 (sec. 203e).

[13] Administrative action may be favored when no significantly unsafe condition existed, no incompetence was demonstrated, the violation was not deliberate and the violator's history and attitude are positive. *Id.*, sec. 205.

[14] For example: 1) Sanctions are not initially proposed with a view to downward negotiation; 2) all mitigating circumstances are considered at the outset; 3) all significant enforcement actions should be coordinated with the Office of Chief Counsel to ensure consistency; 4) record-keeping or "paper" violations are considered serious and any falsification of records will incur the most severe sanctions; 5) voluntary reporting of violations is marginally rewarded; 6) the compliance history of the offender is considered; 7) financial circumstances do not constitute an excuse or ground for mitigation; 8) the FAA's failure to discover violations over a long period is no excuse, though enforcement action may be inappropriate where the FAA affirmatively misled a carrier about compliance issues.

Significantly, guidelines suggest that certificate action (amendment, suspension or revocation) should be the FAA's primary enforcement tool, but that civil penalty action may be preferred when disruption of service will have a substantial adverse impact on the public not outweighed by safety considerations.[15] An Assistant Chief Counsel is responsible for deciding whether to seek suspension or revocation of an aircraft registration certicate for any reason rendering the aircraft ineligible for registration.[16] Any decision to initiate certificate action triggers the adjudicatory-style provisions of the Federal Aviation Act, initially a notice of proposed certificate action, followed by an opportunity to answer and be heard, [17] possibly including an informal conference and a reevaluation of the case. Any person whose certificate is impaired by an order issued by the FAA may appeal to the National Transportation Safety Board (NTSB) which, after notice and hearing, may modify or reverse the FAA order if it finds that safety in air commerce or air transportation and the public interest do not require affirmation of the order. [18] When an order is appealed to the NTSB, the legal office that issued the order will represent the FAA at an evidentiary hearing before an NTSB administrative law judge.[19] Either party may appeal from the ALJ's initial decision to the full Board whose review is limited to considering whether the decision is based on erroneous findings of material facts, a departure from law or NTSB policy, an abuse of discretion or a prejudicial procedural error.[20] Within 60 days after the Board issues its final decision and order, the certificate holder may petition the Court of Appeals for judicial review.[21] Where enforcement action other than certificate action is taken (for example, civil penalties, aircraft seizures, cease and desist and other orders, injunctions, or criminal prosecution), substantially different procedures obtain.[22]

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[15] *Id.* sec. 206a.

[16] *Id.* sec. 304.

[17] Federal Aviation Act, sec. 609, 49 U.S.C. app. 1429. The notice sets out the facts alleged, the regulations in issue and the action proposed; it advises the respondent of the several alternative responses available, including voluntary surrender of the certificate.

[18] *Id.*

[19] Procedures before the NTSB are contained in the NTSB Rules of Practice in Air Safety Proceedings, 49 CFR Part 821.

[20] 49 U.S.C. app. 1429(a). See also Federal Aviation Administration, Compliance and Enforcement Program (Dec. 14, 1988) sec. 1202 (g)(3).

[21] Federal Aviation Act, sec. 1006, 49 U.S.C. app. 1429(a). The litigation is handled by the Department of Justice with the assistance of the NTSB and FAA. In the case of NTSB decisions adverse to the FAA, the agency has no right of appeal. 49 U.S.C. app. 1486.

[22] See Fallon Report to the Administrative Conference of the United States on *Imposing Civil Money Penalties for Violations of the Federal Aviation Regulations: Implementing a Fair and Effective System* (March 1990).

### D. Aircraft and Airport Operations

The FAA naturally also has safety considerations to bear in mind that have more to do with the operation of aircraft in American airspace than with the certification of aircraft and their component parts. The territoriality-based system of airworthiness certification makes it entirely likely that an aircraft will enter the space of a jurisdiction in which neither its generic design, nor its production, nor its individual airworthiness has been certified. For the most part, the nations of the world do not formally require that a craft conform to the national standards of design, production or airworthiness of every jurisdiction where the craft flies. However, the Chicago Convention of 1944, and the international standards and practices administered by the International Civil Aviation Organization (ICAO) created under that convention, seek to assure that aircraft registered in one signatory country meets certain minimum safety standards when operating in the airspace of another signatory country.

Every country also has an evident interest in seeing to it that craft flying in its airspace or landing or taking off at its airports be compatible with the local air control system. Throughout the world, we accordingly find operating rules designed to bring international aviation into line with existing national air controls. The FAA's operating rules are found at 14 CFR Parts 71 through 109. It is plainly essential that all craft used in international aviation meet design standards that will enable them to satisfy the operating conditions imposed by every state in which they may expect to venture. These operating rules apply more broadly than might be expected. For example, FAA regulations require that these rules be followed not only by foreign-registered craft entering the United States but also by American-registered craft wherever they may happen to operate.

Although the FAA's safety agenda thus transcends issues of certification of design, production and individual aircraft, it is these issues that are the focus of the present study.

## III. The FAA's Airworthiness Certification Process and the Aeronautical Industry

The preceding section of this report demonstrates how, under the American regulatory scheme, the registration of individual aircraft is linked to the prior processes of certifying aircraft design and aircraft production quality control methods. The importance of these processes can be particularly well gauged by examining regulatory realities from the aeronautical industry's point of view.

## A. Aircraft Design Certification

An aircraft manufacturer ordinarily will seek design certification, in the form of a "type certificate," for every model of aircraft it places on the market. As indicated earlier, design certification is required not only for aircraft as such, but for component parts such as aircraft engines, propellers and appliances as well.[23] Fresh approval is also required for any major modification of a type-certificated design.[24] More specifically, the Federal Aviation Act invites any interested person--normally a manufacturer--to apply to the Secretary of Transportation for the type-certification of an aircraft or component part.[25] The FAA then conducts an investigation and, in rare instances, holds hearings. It is also authorized by statute to require that the applicant conduct certain physical and performance tests to show that the product design meets FAA standards as set out in the agency's published design regulations and is otherwise safe.[26] If satisfied in all respects, the FAA issues the design certificate.[27] Such certificates may be of limited duration and may contain specific terms and conditions. The fact that the FAA has issued a type certificate or other form of design approval does not relieve the certificate holder of principal responsibility for noncompliance with FAA airworthiness standards or for unsafe design features.[28]

The simplest situation is one in which an American manufacturer of aeronautical products seeks certification by the FAA of one of its designs. In this situation, the manufacturer files directly with the FAA an application for design approval. The procedures for issuance of type certificates to U.S. manufacturers are set out in Federal Aviation Regulation 21.21. These regulations provide for the FAA or its designees to conduct the technical inspections and evaluations required for certification. The FAA aircraft certification staff involved in the certification process consists of engineers, flight test pilots and aviation safety inspectors.

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[23] While "type certificates" are issued for the design approval of aircraft, aircraft engines and propellers, design approval of appliances and articles of equipment to be manufactured outside of the U.S. take the form of "Letters of TSO design approval" to signify that they meet the performance standards of an FAA technical standard order.

[24] In such cases, either a "supplemental type certificate" will be issued, or the existing certificate will be appropriately amended.

[25] Federal Aviation Act, sec. 603 (a) (2).

[26] The FAA regulations containing design requirements are set out in Federal Aviation Regulations (FAR) 23 through 35 (for different kinds of products), and 21, 36, and 91 (for noise standards), as well as Special Federal Aviation Regulations (SFAR) 27 (for fuel venting and exhaust systems) and 41. The FAA also has promulgated a series of Technical Standard Orders (TSO) for certain component parts.

[27] The FAA must "find that such aircraft, aircraft engine, propeller, or appliance is of proper design, material specification, construction, and performance for safe operation, and that [the design] meets the minimum standards, rules and regulations prescribed." Federal Aviation Act, sec. 603(a).

[28] S.A. Empresa de Viacao Aerea Rio Grandense (Varig Airlines), 467 U.S. 797 (1984)

However, a manufacturer typically requests certification of its designs not only--perhaps not even--in the country of its nationality or the place of manufacture, but in all jurisdictions where it foresees that the ultimate purchasers of its products may seek to register them. This results from the fact already mentioned that the airworthiness certification of individual aircraft within any given country depends upon the aircraft's conformity to a design type that has previously been certified within that same country. More specifically, an FAA-type design approval for a product assembled abroad is a prerequisite to the import of the product for eventual registration in the United States, to its operation here under lease or charter by a U.S.-certificated air carrier or operator, or to its installation on an aircraft carrying an American airworthiness certificate. In fact, the FAA does not normally grant type design approvals for foreign-manufactured products unless intended for placement on the U.S. registry, or for operation by a U.S. operator under lease or charter.[29]

In the United States, as in many other countries, the procedures for issuance of type certificates are somewhat different for foreign-manufactured imports than for domestic products. As a later section of this report explains, the FAA's findings of compliance for imported products may be based primarily on the inspections and evaluations performed by the agency's counterpart in the exporting country. The FAA's design certification procedures for imported goods are set out in Federal Aviation Regulations 21.29.

Just as the airworthiness of individual aircraft is dependent on their continuing conformity with approved design and production standards, so these standards too are subject to ongoing monitoring. The FAA's review of the safety performance of approved aircraft designs and of the quality of approved production and maintenance systems may lead it to require that specified changes be made in order for them to retain their certification.

## B. Aircraft Production Certification

This kind of certification is closely linked to the design certification just discussed. According to the Federal Aviation Act, a production certificate is to be issued upon a manufacturer's showing that multiple articles or "duplicates" of an aircraft or aircraft component covered by a design certificate will conform to that certificate.[30] Thus, a production certificate is granted upon demonstration of a quality control system offering reasonable assurances that the aircraft actually produced will conform to the basic design for which a type certificate has been issued or that has otherwise been approved, and that it will be in a condition for safe operation. The FAA is authorized to make or require such tests or inspections as may be necessary to satisfy this standard, and may impose a time limit and other conditions on any production certificate issued.[31] A type certificate or other form of FAA design approval must have been issued before a production certificate can be issued; however, a production certificate is not itself a prerequisite for issuance of an airworthiness certificate for the aircraft produced. It simply facilitates the process by which the latter certification may be achieved and is accordingly advantageous to the aircraft manufacturer and owner alike.

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[29] FAA Advisory Circular No. AC 21-23, at 21.

Unlike FAA design certification, which may be sought by any manufacturer, domestic or foreign, who anticipates registration of aircraft of that design within the United States, FAA production certificates are available exclusively to American aircraft manufacturers. Products imported to the United States for FAA airworthiness certification or approval must be accompanied by an export certificate of airworthiness issued by the aircraft certification authority of the country of manufacture. The export certificate attests to the aircraft's conformity to the FAA-certificated design and to its being in a condition for safe operation. Thus, the purpose that would otherwise be served by issuance of an FAA production certificate is served through another procedure.

## C. Airworthiness Certification

As previously stated, FAA airworthiness certification is required of any aircraft registered in the United States. An airworthiness certificate attests to the conformity of each aircraft with the specifications of an FAA-approved aircraft design and to its being in condition for safe operation.[32] Thus, issuance of a design certificate is an absolute prerequisite to the issuance of an airworthiness certificate (as well as to approval of products for installation on U.S.-registered aircraft). Airworthiness certificates, like the other kinds of certificates, may be issued for a limited duration and subject to specific terms and conditions. Specifically, it is an FAA requirement, and a requirement of most other countries, that aircraft subject to regulation not only meet the relevant standards initially, but also continue to do so. Thus, aircraft must remain in conformity with an FAA-certified design and be maintained in a safe condition. The FAA accordingly also certifies replacement parts, maintenance personnel and repair stations.

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[30] Federal Aviation Act, sec. 603 (b).

[31] *Id.* See Federal Aviation Regulation 21, subparts F & G. The FAA's emphasis on the quality of the production process is to be contrasted with certain other countries' emphasis on the substantiality of the manufacturer's organization.

[32] Federal Aviation Act, sec. 603 (c).

It frequently happens that the owner of a registered aircraft wants to modify the aircraft in a way that will place it out of conformity with the then approved design specifications. Accordingly, a significant civil aircraft modification industry has developed in the United States. The FAA has established procedures to certificate design modifications and to help assure that aircraft so modified conform to the approved design change.

Although the FAA is required by law to make the findings necessary for the approval of a design and for the airworthiness certification of U.S.-registered aircraft, it does have latitude in deciding how such findings are to be made. This means some freedom of choice not only over the kind of evidence to be accepted, but also over the extent to which the FAA itself must exercise independent technical judgment. This latitude has allowed the FAA to enter into cooperative arrangements with selected countries for dealing with the certification of designs or products previously certificated overseas or otherwise imported from abroad. This network of country-to-country agreements is described in section VC of this report.

# IV. The Case for Internationalizing Airworthiness and Related Standards

There are over 30 countries in addition to the United States having a significant aeronautical product manufacturing industry, each with a civil aviation authority regulating such manufacture and operating under that country's laws. Even the briefest account of the FAA's certification activities demonstrates the practical necessity of harmonizing the design, production and airworthiness standards found among these various countries, as well as the operating rules that govern air traffic within them. The factual interdependence characterizing aviation regulation in today's world surfaces at every stage of the FAA's certification activities.

## A. Industry Incentives

The import and export of aviation products is an important feature of the multibillion dollar American aeronautical industry. Unless airworthiness standards are reasonably similar around the world, aircraft manufacturers cannot effectively engage in that manufacture on an international basis. As already noted, the entitlement of an individual craft to airworthiness certification essentially turns on the craft's conformity with an approved aircraft design, which in turn must satisfy applicable airworthiness regulations. Since aeronautical products will eventually have to earn individual airworthiness certification in all countries where their own operators contemplate registering them, manufacturers must be cognizant of airworthiness and design standards in every country in which they see, directly or indirectly, a market. Unless a design offers reasonable confidence in that respect, it is unlikely to prove very attractive on the international market for aircraft. This is true no less for trade in component aeronautical parts than for trade in completed aircraft.

A factor further dramatically favoring the internationalization of airworthiness standards is the growing international character of aircraft manufacture itself. Statistics presented at an international air regulators' conference in Dallas in 1989 demonstrated that all major European aircraft and engines are today being manufactured internationally. Major components for virtually every U.S.-assembled aircraft and aircraft engine are being designed and manufactured all over the world. Likewise, the European Concorde (SST) is a product of France and the United Kingdom; the Fokker F28/100 a product of the Netherlands, Germany, the United Kingdom and France; the Airbus 300, 310 and 320 a product of France, the United Kingdom, Germany, Belgium and Spain; the ATR 42/72 a product of France and Italy; and the SAAB 340 a product of the United Kingdom and Sweden. In addition, parts and equipment for these planes come from Greece, Ireland, Portugal, Austria, Switzerland, Denmark, Finland and Norway, not to mention non-European sources.[33]

Among the prime movants in the early 1970s of a system of European Joint Aviation Authorities--discussed more fully later in this report--was AECMA, the European aeronautical manufacturers association.[34] AECMA's purpose was to stem the proliferation of European airworthiness codes, the emergence of needless national variants, and the growth of discrepancies in the interpretation and implementation even of those provisions in common. In existence at the time were a set of British standards, a French code similar to the FAA's, a German translation of the American standards, and a host of national variations in the other European countries. Quite apart from their inefficiencies in a global setting, regulatory discrepancies raise a prospect of unequal treatment of like products, and therefore a risk of disguised protectionism. From the European point of view, the case for internationalizing airworthiness standards has only been strengthened by the emergence of a very significant European aeronautical manufacturing industry over the last 15 years. Increasingly, it is the European manufacturer of aeronautical products whose research, development and marketing paths are being cleared by the prospect of harmonized airworthiness standards.

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[33] See Koplin, International Manufacturing from the non-U.S. Point of View (presentation at the Conference on Quality in Commercial Aviation, Dallas, March 5-7, 1989).

Joint aircraft development programs involving non-European countries include the BK 117 (Germany and Japan), the SF 340 (Sweden and the U.S.) and the BO 105LS (Germany and Canada). *Id.*

[34] AECMA is the acronym for the Association européenne des constructeurs de materiél aerospatial.

Aircraft operators represent another segment of industry that has encouraged heightened international cooperation on the FAA's part in the airworthiness field. Operators plainly derive an interest in orderly airworthiness regulation from their obligation to register and maintain to standards the craft they operate. In addition, U.S.-manufactured and U.S.-registered aircraft are with some frequency being leased to foreign carriers or operators for use outside the United States. The latter need to keep such aircraft in conformity both with FAA- and foreign-approved designs. Moreover, American operators are permitted to operate foreign-registered aircraft provided those aircraft likewise conform to an FAA-approved design. These and other industry developments favor an approximation of national airworthiness requirements and suggest an opening of regulatory channels with foreign airworthiness authorities.[35]

## B. Foreign Government Incentives

The harmonization of airworthiness standards stands to bring related advantages to the different national regulatory bodies affected. The nations that initially formed the European Joint Aviation Authorities did so in part to overcome difficulties encountered in certificating aircraft that had been manufactured (and possibly also certificated) in countries having somewhat different airworthiness standards. The European regulators plainly and simply sought "to facilitate the import and export of aviation products and the certification of joint products."[36]

A similar logic suggested harmonization on a wider scale, including and especially with the United States. The international aviation industry was traditionally centered in this country, and it made little sense to the Europeans (except from a short-sighted protectionist point of view) to maintain airworthiness standards that impeded the flow of American-made aircraft to European users or of American-made aeronautical parts for use in European products.

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[35] For a description of such trends, see FAA, Export/Import Airworthiness Certification of Civil Aeronautical Products, FAA-P-8110-1 (May 15, 1987), pp. 24-29.

[36] Koplin, European Civil Aviation Regulation Expertise 2.

The European authorities were also in search of a comprehensive set of airworthiness standards. Given the variation among European standards then in place, coupled with the powerful influence over them of the existing American standards, the latter exerted a particular appeal. On the other hand, the pace of technological change in the aviation field (plus a measure of national pride) made it unthinkable that the Europeans would simply adopt the FAA's accumulation of regulations and in effect "freeze" the FARs as they then existed. Collaboration of a more flexible and ongoing nature was indicated.

Although civil aviation is probably not unique in this respect, it is a field marked by technological complexity and rapid development. Among the attractions of the Joint Aviation Authorities to the separate European governments was the difficulty each had been experiencing, and expected to continue experiencing, in maintaining regulatory competence in all fields. Collaboration with the United States authorities offered similar promise not only on account of their accumulated regulatory and technical experience, but also the continuing expertise they could be expected to bring to the solution of newly emerging problems.

## C. American Government Incentives

Faced with the realities of a more diversified aeronautical manufacturing environment, American regulatory authorities have come rather quickly to share their European counterparts' enthusiasm for the harmonization of standards. To begin with, harmonization increases the ease with which American-made products will be welcome for certification and eventual registration abroad. But it is also simply no longer the case, if ever it was, that the FAA can concern itself solely with the conformity of American aviation technology to the needs of air safety. With non-American craft, non-American component parts, and joint aeronautical products assuming an ever larger share of the international market, the FAA needs to be equipped to make airworthiness judgments about designs or products with which it may not be initially familiar and which were conceived against the background of different foreign country airworthiness standards.

I have previously adverted to the government's perceived economic advantage in addressing technological problems jointly with foreign governments. A good example of concerted action of this sort was the convening, at the FAA's invitation, of an international conference on aging aircraft in the aftermath of the 1985 JAL 747 air disaster and the 1988 Aloha accident. The conference, attended by the regulatory authorities and representatives of manufacturers and operators in twenty countries, led to the creation of an international Airworthiness Assurance Task Force on Aging Aircraft and resulting research and development on aircraft fatigue, corrosion, repair and maintenance and flight loads.

Thus far, the discussion of industry and government incentives has focused exclusively on the virtues of a harmonized regulatory environment. As any student of the contemporary administrative process knows, however, rulemaking as such constitutes a small part of that process. The design, production and airworthiness standards with which this study is concerned also require implementation. They need to be applied with respect to particular type designs, particular production processes and individual craft.

The implementation stage of the administrative process opens up large opportunities for collaboration among national airworthiness authorities and corresponding government savings. These opportunities, which obviously present risks as well as promise, are best illustrated by the workings of the many bilateral airworthiness agreements to which the United States is a party. As the discussion in Part IV of this report will show, the mutual recognition of airworthiness certification contemplated by the bilateral agreements depends in turn, as a practical matter, on a certain level of commonality among national regulatory standards. Thus, the prospect of mutual cooperation in the airworthiness enforcement process has served as yet an additional impetus to regulatory harmonization.

## V. The Existing International Framework of Aviation Regulation

The forms of international regulatory cooperation engaged in by the FAA are not taking place in an historical vacuum. Over the years, the traditional territoriality-based system of aviation regulation has at various points taken on a distinct international dimension. Although aviation regulation remains a nationally organized activity, the realities of economic and regulatory interdependence have given certain aspects of international cooperation an ever-increasing importance in that regulatory domain.[37] Even the Federal

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[37] At the time drafting of the Convention on International Civil Aviation began in 1944, most air routes were confined within national boundaries. "International routes, where they existed,

Aviation Act expressly recognizes that international agreements will figure prominently in American aviation regulation.[38]

## A. The Chicago Convention: The International Civil Aviation Organization

The Convention on International Civil Aviation (or the Chicago Convention), which dates from 1944 and now counts over 150 signatory states,[39] represents an undertaking by those states to adopt and enforce a common minimum set of international standards for aircraft, air traffic controller and pilot certification. The Convention resulted from a conference on international civil aviation held in Chicago toward the end of the World War II, by which time the need for orderly development of civil aviation had become apparent.[40] The Convention's basic idea is that each state party undertakes not to reexamine the soundness of aircraft or pilots entering its airspace when the craft or pilots, as the case may be, are already certified by the authorities of another Convention state as meeting the ICAO standards. The agreement to extend such "full faith and credit" to foreign country certification naturally depends on the existence of a common international minimum standard for aircraft, air traffic controllers and pilots, as well as uniform visual and instrument flight rules.[41] It is through its various annexes (particularly annex 8 on "Aircraft Design and Quality Control") that the Convention establishes these minimum standards in the form of International Standards and Recommended Practices (SARPs). The development and improvement of standards is entrusted under the Convention to the Montreal-based International Civil Aviation Organization (ICAO). Altogether, ICAO has adopted 17 annexes covering a wide spectrum of aviation specifications. Each state party to the organization is entitled to representation at meetings of

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consisted mostly of short trans-border hops." International Civil Aviation Organization, The Convention on International Civil Aviation: The First Thirty-Five Years 3 (1979).

[38] Federal Aviation Act, sec. 1102, requiring that the Administrator exercise his authority "consistently with any obligation assumed by the United States in any...agreement that might be in force between the United States and any [other] countries, and shall take into consideration any applicable laws and requirements of [other] countries."

[39] 61 Stat. 1180 (Dec. 7, 1944), eff. April 4, 1947.

[40] Although the Convention accepts the principle that every state has compete sovereignty over its airspace, it provides for the adoption of international standards and practices of air navigation. Each state agrees to help secure the highest practicable degree of uniformity in regulations and procedures.

[41] See in particular articles 33 and 37 of the Convention on the development of international airworthiness standards.

the ICAO Assembly, which take place at least once every 3 years. The Assembly makes its decisions by majority vote, but most of ICAO's work is accomplished through its 30-member Council, assisted by a standing committee of experts known as the Commission[42] and by various technical panels.[43] The American delegate to ICAO enjoys ambassadorial rank.

The ICAO mechanism also presupposes that the participating states will in fact establish and enforce regulations that satisfy ICAO standards. ICAO standards are not self-executing and each state is charged with implementing them. Article 38 of the Convention requires that a state notify ICAO if it finds it impracticable to comply with an ICAO standard and indicate the respect in which national standards fall short. Although the FAA generally has no problem in satisfying ICAO standards--and considers if official policy to satisfy them[44]--it contemplates a number of situations in which noncompliance might occur. These circumstances are unfortunately very broadly conceived.[45] On the other hand, the FAA has adopted practices designed to minimize the likelihood of noncomplicance.[46]

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[42] The Commission also comprises representatives of aircraft manufacturers and of the leading manufacturing states.

[43] Specifications proposed to be adopted as SARPs, and normally incorporated in Convention annexes, are developed by the Air Navigation Commission upon consultation with all contracting states, and then submitted to the Council for adoption by a two-thirds majority. Following their adoption and provided a majority of contracting states does not disapprove them, SARPS become effective at dates set by the Council. International Civil Aviation Organization, Memorandum on ICAO 18 (1981).

[44] FAA Regulatory Handbook §13-3.

[45] Situations justifying noncompliance include the following:

"(1) Implementation would be detrimental to the national interest.

(2) Implementation cannot be effected without obtaining new or amended legislation.

(3) Necessary funds are not available.

(4) Implementation would work a substantial hardship on the various aviation activities of the United States.

(5) Existing national practices provide a greater degree of safety.

(6) Implementation would conflict with the principles upon which United States requirements are established." *Id.* §13-3(a).

[46] FAA offices amongst responsibility for rule development are required to ensure that ICAO standards are consulted and presumably observed prior to issuing an NPRM or final rule. Such offices are further required, whenever advised of a new or amended ICAO standard, to review FAA regulations, determine whether a difference exists and, if so, either seek to amend the FAA standard or process a notice to ICAO of the difference. Finally, these offices have a standing duty to review existing differences that have been notified to ICAO to determine whether it is appropriate to rescind notices that are no longer apt, to initiate amendments to FAA standards to produce compliance, to propose amendments to the relevant ICAO standards, or to maintain existing differences. *Id.* §13-4(a),(b),(c).

In addition to developing the minimum airworthiness specifications embodied in Annex 8, ICAO has formulated detailed Procedures for Air Navigation Services (PANS), which are considered inappropriate for inclusion in the SARPs. Once approved by the ICAO Council, they are simply recommended to contracting states for national adoption.[47] ICAO also produces an Airworthiness Technical Manual which contains nonbinding guidance material designed to assist member states in developing and improving their own national airworthiness requirements.

Under the Chicago Convention, the state of registry of an aircraft is required to inform the state of manufacture when it initially enters on its registry an aircraft of a type certified by the latter. This will enable the state of manufacture to notify all states of registry of any information about the aircraft's continuing airworthiness of which it becomes aware. Conversely, the state of registry must bring all continuing airworthiness information about a given aircraft type to the attention of the state of manufacture so that the latter may transmit it to all other contracting states known to have such aircraft on their registers.

In sum, the International Civil Aviation Organization has produced more a framework for international cooperation in airworthiness than an airworthiness code as such.[48] Moreover, rather than establish a common inspection system among the member states, it simply requires that each state inspect locally-manufactured aircraft in accordance with a state-approved inspection system and ensure that such aircraft conform with the corresponding approved design.[49] A recent initiative of ICAO is the establishment of minimum standards for structural inspection of older aircraft.

The ICAO framework must be counted a limited one from several points of view. First, the organization lacks any inspection capability and engages in no enforcement activity whatsoever. Its standards, though binding on the state parties to the Convention appear, as a practical matter, to be widely disregarded by many of those parties. In the second place, the standards that emerge from the process of consensus-building through negotiation among 150 different states tend to represent a lowest common denominator in airworthiness; the FAA in any event does not regard them as adequate from an air safety point of view.[50] Accordingly, the FAA is not obligated to and does not accept export certificates of airworthiness for the import of aeronautical products into the United States merely because those products satisfy the criteria of annex 8 or because the exporting country is a Convention party.[51] Consideration was at one time given to establishing uniform rather than minimum standards under the Convention, but this was not done,[52] partly because agreement could not be reached as to whose national standards--those of the U.S. or the U.K.-- should form the basis for the Convention's standards. Finally, the ICAO rules take the form of performance rather than design standards and therefore do not satisfy any given state's need for a comprehensive airworthiness code. All in all, from a procedural and a substantive viewpoint alike, the ICAO mechanism continues to leave essential responsibility for airworthiness regulation in national hands.

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[47] International Civil Aviation Organization, Memorandum on ICAO 18 (1981).

[48] Thus, ICAO has developed a system of uniform aeronautical symbols and terms and recommends ways of facilitating the flow of air traffic particularly along heavily travelled routes. It has proposed ways of simplifying customs, immigration, public health and other procedures for passengers, crews, baggage, cargo and mail, and established minimum essential services and facilities at international airports. Improved airport and aircraft security has been its latest concern.

[49] ICAO, annex 8, part II, sec. 3.1.2. The first edition of Annex 8 was adopted by the ICAO Council on March 1, 1949.

American participation in ICAO raises the question of how national representatives see to it that the positions they adopt at international regulatory gatherings reflect the views of other government agencies interested in the outcome of such activity. Although the United States is represented at Montreal by an official of the Federal Aviation Administration, international aviation necessarily interests other agencies as well. To this end, there has been created an Interagency Group on International Aviation, bringing together representatives of the Departments of Commerce, Labor, State and Transportation, and the Office of United States Trade Representative.

## B. GATT, the Standards Code and the Trade Agreements Act of 1979

National airworthiness standards are affected not only by the level of agreement, albeit modest, reached through ICAO, but also by international agreements respecting nontariff trade barriers. The 1979 Tokyo Round of multilateral trade negotiations under the auspices of GATT produced two related instruments of importance to the subject of airworthiness, namely the Agreement on Trade in Civil Aircraft (the Aircraft Agreement)[53] and the Agreement on Technical Barriers to Trade (the Standards Code).[54] Article 3 of the Aircraft Agreement provides in effect that the Standards Code shall apply to trade in civil aircraft, in particular to "civil aircraft certification requirements and specifications on operating and maintenance procedures."[55]

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[50] See FAA, Export/Import Airworthiness Certification of Civil Aeronautical Products, FAA-P-8110-1 (May 15, 1987), p. 10. The Convention's requirement of the highest practical degree of uniformity in regulations does not necessarily facilitate adoption of the highest standards.

[51] *Id.*

[52] "It is recognized that ICAO Standards would not replace national regulations and that national codes of airworthiness containing the full scope and extent of detail considered necessary by individual States would be required as the basis for the certification of individual aircraft. Each State is free to develop its own comprehensive and detailed code of airworthiness or to select a comprehensive and detailed code established by another Contracting State." International Civil Aviation Organization, The Convention on International Civil Aviation: The First Thirty-Five Years 16 (1979).

The Standards Code has as its principal objective to ensure that national air transport safety measures are not employed and do not function as disguised trade barriers. To that end, the Code requires that national certification authorities grant foreign manufacturers in signatory countries (and hence foreign products) the same market access as they grant to domestic manufacturers. More specifically, those authorities are required to accept test results, certificates or marks of conformity issued by the country of export whenever they have reasonable assurance that the procedures were performed by competent bodies using appropriate methods. The Code further calls upon states to express their national standards whenever possible in terms of performance rather than design, to develop their standards and certification systems in accordance with open and public procedures, and to provide less developed countries technical assistance in their own development of such systems. Like GATT violations generally, violations of the Standards Code are subject to established dispute resolution procedures. The Standards Code and Aircraft Agreement are implemented in the United States by titles IV and VI of the Trade Agreements Act of 1979, effective January 1, 1980,[56] and the United States is represented in GATT-related procedures by the Office of United States Trade Representative.

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[53] General Agreement on Tariffs and Trade, Agreement on Trade in Civil Aircraft, Geneva (April 19, 1979).

[54] General Agreement on Tariffs and Trade, Agreement on Technical Barriers to Trade (Relating to Product Standards), MTN/NTM/W/192/Rev. 5 (March 29, 1979).

[55] The Aircraft Agreement defines civil aircraft as "all aircraft other than military aircraft," including engines and other parts and components, "whether used as original or replacement equipment in the manufacture, repair, maintenance, rebuilding, modification or conversion of civil aircraft."

[56] Trade Agreements Act of 1979, title IV ("Technical Barriers to Trade (Standards)"), secs. 401 et seq., title VI ("Civil Aircraft Agreement").

## C. Bilateral Airworthiness Agreements

As indicated earlier, the International Civil Aviation Organization has not undertaken to promulgate a uniform international airworthiness code, though its minimum standards mechanism does enable pilots and aircraft to cross national borders in the course of international aviation. ICAO accordingly does not adequately assist manufacturers and others engaged in the international marketing of aeronautical products in facilitating the registration and certification of such products by their prospective owners and operators in different jurisdictions. Even before ICAO was established, or the Standards Code promulgated, the United States began entering into bilateral airworthiness agreements with selected countries, that is, countries in whose standards and procedures we had particular confidence and therefore to whose judgments about airworthiness we might be prepared to grant full faith and credit.

The United States entered into its first bilateral airworthiness agreement with Canada in 1929, in the form of an executive agreement. Twenty-six such government-to-government agreements are now in effect between the United States and countries deemed to have both a competent aviation authority and aeronautical product manufacturing industry[57]. The FAA has begun work with a number of additional countries (including China and the Soviet Union) to broaden its number and range of bilateral airworthiness agreements. The decision whether to enter into a bilateral agreement with a given country--a decision made by the FAA in consultation with an interagency group on international aviation[58]--depends upon a number of considerations. These include: (1) the quality of the foreign state's airworthiness laws and regulations, (2) the technical competence and efficacy of the foreign aviation authority, (3) the design and manufacturing capabilities of the local industry, and (4) the prospects for export of the country's aeronautical products to the United States. No federal statute or regulation or international treaty requires such agreements. They have been entered into, at the initiative of the United

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[57] These countries are Argentina, Australia, Austria, Belgium, Brazil, Canada, Czechoslovakia, Denmark, Finland, France, Germany, Indonesia, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Poland, Romania, Singapore, South Africa, Spain, Sweden, Switzerland and the United Kingdom.

The Department of State has determined that bilateral airworthiness agreements come within the President's authority to enter into executive agreements as recognized by Federal Aviation Act, sec. 802, 49 U.S.C. sec. 1462. See Department of State, Memorandum of Law, dated December 5, 1972 (Subject: Circular 175-Request for Authorization to Negotiate and Sign New Bilateral Airworthiness Agreements).

[58] See page 32 *supra*.

States or a foreign country, only as and when the FAA determines that the other country has an aeronautical product manufacturing industry of significance whose products may be exported to the United States. Bilateral agreements typically come into effect upon the exchange of diplomatic notes, with a State Department official signing for the United States. They normally allow a contracting state that has lost confidence in another country's airworthiness authority or standards, in its discretion, to terminate its agreement with that country after a specified time following the giving of written notice.[59]

Bilateral airworthiness agreements differ substantially in scope. The more limited among them merely facilitate the other country's export of component parts manufactured to previously FAA-approved designs, while the more complete cover the import and export of an entire range of aeronautical products.[60] Generally speaking, however, bilateral airworthiness agreements obligate the aviation authorities of each country to treat as established the airworthiness of a civil aeronautical product imported from the other country (including those partially or wholly manufactured there) once the product is shown to have been certified by the other country's competent authorities. Bilateral agreements commonly read: ". . . the importing State shall give the same validity to the certification made by the competent aeronautical authority of the exporting State as if the certification had been made by the importing country's own competent aeronautical authority in accordance with its own applicable laws, regulations, and requirements." Aviation authorities of the importing state thereby give the fullest credit possible to the airworthiness functions performed by the exporting state under the latter's own domestic certification system, thus avoiding the burdens and costs of essentially duplicative testing and certifying. On the other hand, even though two states have entered into such an agreement, the airworthiness criteria and practices prevailing in the two states may not be identical. That is to say, the importing state may impose additional or more stringent criteria than the exporting state and may require that those criteria be met. Accordingly, bilateral airworthiness agreements typically go on to provide:

> The aeronautical authorities of the importing State shall have the right to make acceptance of any certification by the aeronautical authorities of the exporting State dependent upon the product meeting any additional requirements which

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[59] A typical clause to this effect reads: "Either Contracting State may terminate (the) Agreement at the expiration of not less than 60 days after giving written notice of that intention to the other State." This is understood to allow termination for any reason within the discretion of the country invoking the right. Advisory Circular No. AC 21-18, at 3.

[60] See Sullivan, A Framework for the Development of Compatible Cabin Safety Standards.

> the importing State finds necessary to ensure that the product meets a level of safety equivalent to that provided by the applicable laws, regulations, and requirements which would be effective for a similar product produced in the importing State.[61]

The FAA emphasizes that these accords do not constitute trade agreements so much as agreements for technical cooperation.[62] This is demonstrated by the fact that the FAA treats an aircraft as "imported" for these purposes only if it is intended to be placed on the U.S. registry, and other civil aeronautical products only if intended for installation on U.S.-registered aircraft.[63] On the other hand, the FAA considers bilateral airworthiness agreements essential for these purposes. It generally will not issue approvals of imported civil aeronautical products for purposes of U.S. certification unless such an agreement is in effect with the exporting country.[64] As a result, the United States has sought to enter into bilateral agreements with all countries having an aeronautical manufacturing industry whose products are likely to be exported to the United States. The situation is different so far as the export of American-manufactured civil aeronautical products are concerned. These may be exported to and imported by countries having no bilateral airworthiness agreement with the United States.[65]

A freer mobility of aircraft and aircraft components is of obvious utility to all parties in the international chain of aircraft manufacture and distribution, especially as aircraft and aircraft components are increasingly sold for use in a jurisdiction other than that where they have been designed and manufactured. Bilateral airworthiness agreement contribute to freer mobility at each of the certification stages set out earlier in this report: acceptance of new aeronautical design technologies, conformity of aircraft to previously accepted designs, and the assessment of production processes. The subsections that follow show how industry and government savings can flow from a national authority's reliance on technical investigations that have been adequately performed by counterpart agencies abroad.

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[61] This language is actually taken from the U.S./U.K. agreement, TIAS 7537, 49 Stat. 3652 (1972).

[62] Advisory Circular no. AC 21-23, at i-ii; Advisory Circular no. AC 21-18, at 2.

[63] *Id.*

[64] See Federal Aviation Regulation 21.29. The FAA implements its bilateral airworthiness agreements through its export and import certification regulations under FAR 21. These include FARs 21.29, 21.183(c), 21.500, 21.502, 21.617, and Subpart L.

[65] Most European countries do not require bilateral airworthiness agreements for these purposes. See Koplin, *supra* note 36.

## 1. Design Certification under Bilateral Airworthiness Agreements

Federal Aviation Regulation 21 provides that type certificates may be issued under either the standard procedures of FAR 21.21 (for approval of U.S.-manufactured products) or FAR 21.29 (for approval of imports to the United States). Under the standard procedures, the FAA essentially conducts its own technical inspections and evaluations for purposes of establishing conformity with American airworthiness standards, while under FAR 21.29, such findings may be based primarily on the inspections and evaluations, and ultimately the certifications, performed by the civil authority of the exporting state.

FAR 21.29 contemplates issuance by the FAA of a type certificate for a product to be manufactured in a country with which the United States has a bilateral airworthiness agreement and then imported into the United States. As a preliminary matter, an applicant must demonstrate that the product for which design certification is sought is in fact destined for export to the United States and that the product falls within the scope of the relevant bilateral airworthiness agreement. As to its merits, the application must include proof to the FAA of certification by the foreign authority that the product in question has been tested and meets FAA airworthiness standards. The application must contain all the required technical data, with manuals, placards, listings and instrument markings in the English language. Commonly the application will identify the foreign country airworthiness standards upon which the foreign authority originally based its design approval, and will cite the American airworthiness standards that are believed thereby also to be satisfied. It will normally also identify any unusual design features that the applicant or the foreign authority believes may necessitate issuance by the FAA of a special condition,[66] an exemption, or an equivalent safety finding. It is ultimately for the FAA, of course, to determine whether in fact the airworthiness standards and practices applied by the foreign authority correspond with American certification requirements.[67]

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[66] A special condition needs to be issued if the FAA finds that its airworthiness standards do not contain adequate or appropriate safety standards for a product (or a product feature) because of a novel design characteristic of that product or feature. The issuance of FAA special conditions is done through the public rulemaking procedures set out in FAR 11 and is designed to yield such safety criteria for a given product as the FAA finds necessary to establish a level of safety equivalent to that established in the ordinarily applicable airworthiness standards. See FAR's 21.16 and 21.101.

In principle, FAA special conditions issued for imported products are the same as would be issued for a similar product made in the United States.

[67] Advisory Circular no. AC 21-23, at 22-23.

As a practical matter and in accordance with FAA preferences, the foreign aviation authority itself, rather than the foreign manufacturer, will file the application for FAA design certification. In this event, the manufacturer submits the aplication and supporting materials to its own certification authority with a request that the whole be forwarded to the FAA certification office responsible for the country in which the manufacturer is located. For example, the application for an FAA type certificate for the Airbus A 320 was officially filed by the French aviation agency (Direction générale de l'aviation civile, or DGAC) on behalf of Airbus. In completing execution of the application, DGAC certified that the design satisfied French airworthiness standards as well as American ones, to the extent they were the same. Actually the DGAC went further still, for it also determined, on behalf of the FAA, whether the design also satisfied FAA airworthiness standards to the extent that they exceeded or otherwise differed from French standards. In other words, the foreign authority supplies certification to the FAA not only with respect to shared or common standards, but also those peculiar to the United States.

Bilateral airworthiness agreements nevertheless leave scope for FAA technical involvement in the approval of foreign designs. The FAA must become sufficiently familiar with the general design, performance and operational characteristics of a product in order to determine whether the product would have met U.S. airworthiness standards if produced domestically, as well as to conduct any post-certification responsibilities (such as handling service problems, or approving design or flight manual changes) that may arise. (The first determination is called establishing "the normal U.S. certification basis" of the product in question.) Finally, of course, the FAA must identify any additional technical conditions, beyond those applied by the foreign authority, that compliance with FAA certification standards will require.[68]

In a fundamental way, the borrowing of design certification functions presupposes a basic familiarity on the part of the FAA with the foreign certification system and standards (and their comparability with those of the

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[68] FAA additional technical conditions are those that must be satisfied above and beyond the certification standards of the exporting state in order to meet the standards necessary for FAA approval. Normally these can be determined simply be comparing the two countries' basic airworthiness standards. However, it is also possible that (1) the product had been granted an exemption from the exporting state's airworthiness standards, (2) that unusual design features will require that the FAA issue special conditions, (3) that the exporting state directed mandatory airworthiness actions on account of unsafe conditions during operations, or (4) the FAA has identified additional optional conditions that would assist an eventual U.S. operator in complying with independent U.S. operational or maintenance requirements. In these situations, too, FAA additional technical conditions may be specified. Advisory Circular no. AC 21-23, at 28.

United States) as well as sufficient liaison with the foreign aviation authority to ensure that any technical or administrative questions that may affect American certification are identified and resolved. The FAA's interest and involvement in its counterpart's performance of design certification functions under a bilateral agreement normally cause it to designate a particular FAA unit (either a geographic office or technical directorate) having overall management of the project and to appoint an individual project manager. The foreign aviation authority will be informed of the FAA office and individual having project management responsibility. Although the foreign manufacturer is not barred from direct correspondence with the FAA on technical or policy issues that may arise, FAA policy is that the foreign authority remain fully involved:

> [B]ecause the FAA relies heavily on the [foreign civil aviation authority's] understanding of FAA's position on such issues, it is imperative that the ]foreign authority] be included in any such meetings or correspondence. Also, FAA will normally seek the [foreign authority's] opinions before significant issues are resolved and, accordingly, may decline to meet with the applicant to discuss and resolve technical issues unless the [foreign authority] is adequately represented at the meeting.[69]

As soon as practicable, a "familiarization briefing" will be scheduled at a mutually agreeable location in order for the applicant, the foreign civil aviation authority and the FAA to meet and discuss the design. The FAA typically has its foreign counterpart arrange the meeting and considers the latter's attendance mandatory. Discussion will cover unusual design features that might necessitate the issuance of special conditions, any prior service history of the product and comparisons between the relevant foreign and American airworthiness criteria.

Cooperation between the FAA and its foreign counterpart does not end with the familiarization briefing; it continues throughout the design certification process. For example, the FAA needs to know of any unusual design features that come to light during further design development that might necessitate amendment of the U.S. type certification basis, issuance of unexpected special conditions or negotiations on acceptable means of compliance. It also needs to know of any relevant changes in the foreign authority's certification basis. Quite apart from these eventualities, the FAA may request additional technical data, or assistance in conducting inspections or test flights, and cooperation by the foreign aviation authority is obviously crucial, especially where there is a need to verify manufacturer-supplied data.

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[69] *Id.* at 26.

Conversely, the FAA will share with the foreign authority the various technical and regulatory status reports produced in the course of final U.S. certification of the foreign design.

Prior to a final certification meeting, the FAA will require formal assurance from the foreign aviation authority that the applicant has demonstrated the design's compliance with the applicable American airworthiness criteria. At that meeting, it will be determined whether all items on the Type Certification Compliance Checklist drawn up for the project have been received either by the foreign authority or the FAA, as the case may be. If so, FAA type certification (or, in the case of materials, parts or appliances, some other form of design approval) will follow.

In the Airbus example given earlier, the FAA essentially lent credence to the DGAC's determination both with respect to Airbus' satisfaction of standards common to France and the United States, and to its satisfaction of any additional or different American requirements, though, particularly as to the latter, the FAA exercised some review of the DGAC's determination. The FAA estimates that, as a general rule, over 90 percent of the work involved in aircraft design approval of imported products is done by the aviation authority of the manufacturer's country.

Although the procedures followed by the FAA in certifying the airworthiness of imported product designs differ materially from those applicable to domestic product designs--chiefly through reliance on certification functions performed by the exporting state--the FAA's eventual issuance of a type certificate still constitutes a formal FAA finding that the relevant American airworthiness standards or their equivalent have been met. The certificate has the same technical and legal significance as if issued on the basis of local inspection and evaluation, and the FAA is no less legally responsible for the accuracy of the underlying determinations than would be the case if all testing and evaluation had been performed locally by its own personnel.[70]

## 2. Airworthiness Certification under the Bilateral Agreements

Thus far, my emphasis in discussion of the bilateral airworthiness agreements has been on cooperation in design certification. As indicated at the outset of this report, however, airworthiness approval is also needed for specific products and, like the designs, these too may be imported rather than domestically produced. Once again, the international procedures developed by the FAA for these purposes seek to exploit fully the aircraft certification services that may have previously been performed on the product in the place of manufacture or export. The bilateral agreements foresee this form of cooperation as well.

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[70] Advisory Circular AC No. 21-18, at 2.

In general, in order to earn FAA airworthiness approval, individual aircraft manufactured abroad must be accompanied by an export certificate of airworthiness by the civil aviation authority of the manufacturing or exporting country, with any deviation from an FAA-approved design noted thereon. United States registration of imported aircraft understandably also entails certain administrative steps--the application of new registration markings, issuance of a new identification plate, evidence of deregistration from the foreign registry, production of approved flight manual and placards in English as well as logbooks and maintenance records, recording of aircraft titles and security documents--that lie outside the scope of this study. The real interest of the process for our purposes lies in the reliance placed on export certificates of airworthiness in the issuance of U.S. airworthiness certificates for imported aeronautical products.

As was the case for design certification, legal responsibility for the U.S. airworthiness certification of individual craft remains with the FAA. Before issuing such a certificate, the FAA must find that the aircraft conforms to an FAA-approved design and that it is in a condition for safe operation. However, export certificates of airworthiness by the country of export greatly facilitate airworthiness certification by the new country of registry. A bilateral airworthiness agreement, where applicable, may enable the FAA to base its airworthiness findings in whole or in part on the other country's export certification. The situation is at its simplest when the imported aircraft is covered by a type certificate that itself was issued under the bilateral airworthiness agreement procedures described above. In principle, the craft will be entitled to U.S. airworthiness certification upon a simple export certification by the authorities in the country of manufacture that it conforms to an FAA-approved type design and is in a condition for safe operation.[71] Before issuing its own airworthiness certificate, the FAA will simply examine the aircraft to determine that it has not deteriorated or been modified.

If an aircraft is exported to the United States from a country other than the country of manufacture--and if our bilateral agreements with both the manufacturing and exporting countries contain the appropriate language--the FAA will accept export certificates of airworthiness issued by the exporting country, provided of course it furnishes the usual assurances about conformity to an FAA-approved design and safe operating condition. The following remark in the FAA's relevant advisory circular reveals the complexity of the three-country situation:

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[71] Federal Aviation Regulations 21.183(c), 21.185(c). The FAA expects that the aircraft will have been fully assembled and flight tested, and the engines and propellers performance tested, before the export certificate is issued.

> In such cases, the FAA considers it incumbent upon the [civil aviation authority] issuing the export certificate to consult with both the civil aviation authority of the country of manufacture and the FAA to assure it has adequate knowledge of the type design approved by the FAA. Configuration variations, modifications, and major repairs that are not FAA-approved should be identified, and FAA approval should be obtained before the [exporting civil aviation authority] issues its export certificate of airworthiness .[72]

Where an imported aircraft is in used condition, applicants for a U.S. airworthiness certificate have the added burden of identifying repairs and modifications that may have taken place, as well as documenting all maintenance and installation of new equipment. This may entail extensive inspections by a variety of sources, including the civil aviation authority of the place of export and/or of manufacture.

The situation is not fundamentally different for the certification of imported engines, propellers or other component parts and appliances. Federal Aviation Regulations 21.500 and 21.502 provide for the airworthiness certification of foreign-manufactured parts for which a U.S. type certificate or other form of FAA design approval has previously been issued. Such products are considered approved for installation on U.S.-registered aircraft when accompanied by a current export certificate of airworthiness issued by the authorities of the manufacturing state. Predictably, the export certificate needs to state that the part conforms to a U.S. type certificate, passed a final operational check by the manufacturer and is in a condition for safe operation. Nevertheless, the person returning to service the aircraft on which the component part has been installed bears legal responsibility for determining that the part (1) has not been modified or damaged subsequent to the time of export certification, (2) complies with all applicable FAA airworthiness directives, (3) has been installed properly and is in a condition for safe operation, and (4) is accompanied by the necessary maintenance documentation. Installation or replacement of parts thus obviously requires additional inspections and verifications that can be feasibly performed only on the importing side.

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[72] Advisory Circular No. AC 21-23, at 44. Early bilateral airworthiness agreements did not adequately cover the three-country situation. See FAA, Export/Import Airworthiness Certification of Civil Aeronautical Products (FAA-P-8110-1)(May 15, 1987), p.7

Plainly, the FAA places extensive reliance upon the airworthiness certification authorities of other states in the issuance of airworthiness certificates for individual imported aircraft. The extent of that reliance is shown by the fact that the FAA will simply not ordinarily issue a U.S. airworthiness certificate for a foreign-manufactured aircraft--new or used--unless accompanied by an export certification.[73] At the same time, some auxiliary FAA inspection may still be necessary, for example to ensure that no changes or modifications were made (and that no deterioration of aircraft condition occurred) since the time of export certification. Where reassembling has taken place, FAA flight testing may also be required.

### 3. Production Certification under the Bilateral Agreements

Reference was earlier made in this report to a third form of FAA certification, namely aircraft production certification.[74] Ordinarily, FAA approval of an American manufacturer's production and quality control system serves to facilitate the airworthiness certification of products manufactured at that facility, that is to say, the assurance that such products will conform to an approved design and be in a condition for safe operation. However, a production certificate is not a legal prerequisite for the issuance of airworthiness certificates for particular craft, even in the case of domestic manufacture. Thus, the use of bilateral airworthiness agreements for certifying foreign production processes is less critical than for certifying foreign designs and products. On the other hand, direct production quality control by the FAA of foreign manufacturing systems would simply not be technically or politically feasible.

Accordingly, the FAA does not use its bilateral agreements to certify overseas production as such. In effect, it treats a foreign country's issuance of an export certificate of airworthiness for individual craft as indirectly approving the production system, but only with respect to countries with which the United States has a bilateral airworthiness agreement. The use of such agreements for drawing inferences about the quality of overseas production only underscores the importance of carefully evaluating a foreign aeronautical industry and the airworthiness performance of the foreign country's aviation authorities before entering into a bilateral airworthiness agreement with that country.

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[73] *Id.* at 46.

[74] Production certification, it will be recalled, is to be distinguished from design certification and the airworthiness certification of aeronautical products including complete aircraft.

## 4. General Considerations

The preceding discussion demonstrates that both the initial decision of the FAA to enter into a bilateral airworthiness agreement with a given country and the practical implementation of the agreement presupposes a considerable sharing of information between or among national civil aviation authorities. Predicating an airworthiness finding on a design's or a product's certification abroad requires familiarity with the other country's certification system, performance by the FAA of advisory services respecting the U.S. certification system, continuous monitoring of the other authorities' performance, and an awareness of equivalence or lack of equivalence in standards. These modes of cooperation also presuppose that the aviation authorities remain in close liaison and cognizant of changes in the other's technical, legal and regulatory environment.[75] The FAA implements its bilateral airworthiness agreements through detailed export and import certification procedures set out in Part 21 of the Federal Aviation Regulations.[76]

The adequacy of the FAA's current bilateral airworthiness agreements lies outside the scope of this study. Suffice it to say that the "bilaterals" do not address all issues, especially the emerging problems of multistate aviation products. However, over the 60 years of their existence, they have been made more modern and complete, while still allowing for differences in scope and coverage depending on the country in question.[77] Many have been revised and updated, and additional revisions are contemplated. According to the director of the FAA's Aircraft Certification Service, there is no documented evidence that any aircraft accident has been caused by a weakness in the aircraft certification process under a bilateral airworthiness agreement.

The question has arisen whether the continued existence of bilateral airworthiness agreements of differing scope with selected countries is consistent with obligations assumed by the United States under the GATT's Aircraft Agreement and Standards Code. The State Department has concluded, by memorandum of law dated December 5, 1972 (Subject: Circular 175-

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[75] A bilateral airworthiness agreement thus typically provides: "The aeronautical authorities of each Contracting State shall keep aeronautical authorities of the other Contracting State currently informed on all relevant laws, regulations, and requirements in their State."

[76] There are separate FAA procedural requirements for issuance of type certificates for imported aircraft, engines and propellers (FAR §21.29), issuance of airworthiness certificates for the import of foreign-manufactured aircraft (§21.183 (c)), issuance of export airworthiness approvals (subpt. L), approval of foreign-manufactured engines and propellers (§21.500), approval of foreign-manufactured material, parts and appliances (§21.502), among others.

[77] Respects in which bilateral airworthiness agreements have been improved over the years are described in FAA, Export/Import Airworthiness Certification of Civil Aeronautical Products, FAA-P-8110-1 (May 15, 1987), pp. 7-8.

Request for Authorization to Negotiate and Sign New Bilateral Airworthiness Agreements), that the FAA's policy of requiring bilateral airworthiness agreements for the recognition of foreign certifications, and of negotiating them individually, falls within the GATT exception, in Article XX(b), permitting the adoption of measures "necessary to protect human...life or health..." The Department continues to justify the requirement of such agreements and their selective character, even after the Aircraft Agreement and Standards Code, on the ground that they simply carry out the understanding embodied in those instruments that foreign government testing and certification deserve recognition only when performed by a technically competent body using appropriate methods.[78] At the same time, of course, the FAA seeks to ensure that other countries do not maintain civil aircraft import practices that operate as trade barriers to American products.

Plainly enough, the mutual recognition of airworthiness determinations makes no sense unless each party to a bilateral agreement is satisfied with the level of competence shown by the other's enforcement authorities. But it also makes no sense unless the basic airworthiness standards in the two countries are reasonably similar. There would simply be no point in agreeing to treat airworthiness certification performed in Canada as decisive of a design's or a craft's airworthiness in the United States unless the American airworthiness standards or type specifications, as the case may be, are ones that the Canadian authorities can recognize and administer. As already indicated, it can happen that the exporting country's standards are basically equivalent to the importing state's, but differ or fall short in one or another respect, and therefore bilateral airworthiness agreements commonly allow the importing state to prescribe additional technical conditions necessary to ensure that a covered product does indeed meet that state's required level of safety.[79] The fact remains that such agreements cannot yield much mutual recognition or "credence" absent a fundamental commonality of standards.[80]

Bilateral agreements of course do not themselves unify or harmonize national airworthiness standards. But the advantages to private enterprise and regulators alike of mutual recognition of airworthiness determinations have created an important incentive to harmonization of those standards. Reasonably common airworthiness standards in turn create an environment that favors joint national development of new aeronautical technologies and the related regulatory standards.

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[78] *Id.* at 14. Countries that are parties to the Aircraft Agreement incorporating the Standards Code, but with which the United States has no bilateral airworthiness agreement, include Chile, Egypt, the European Economic Community, Greece, Hong Kong, Hungary, Ireland, Korea, Luxembourg, Pakistan, the Philippines, Tunisia and Yugoslavia.

[79] A typical clause to this effect reads: "The aeronautical authorities of the importing State shall have the right to make acceptance of any certification by the aeronautical authorities of the exporting State dependent upon the product meeting any additional requirements which the importing State finds necessary to ensure that the product meets a level of safety equivalent to that provided by the applicable laws, regulations, and requirements which would be effective for a similar product in the importing State."

[80] Advisory Circular no. AC 21-18, at 2.

## D. Harmonization of National Airworthiness Standards

The preceding discussion shows that, although the network of bilateral airworthiness agreements to which the United States is a party decidedly facilitates international trade in aircraft, simplifies administrative responsibilities in airworthiness regulation and indirectly promotes aeronautical innovation, it does not of itself produce a harmonized regulatory environment. The ICAO and GATT initiatives, discussed still earlier in this report, though also favorable, have not substantially produced that result either.

Historically, substantial harmonization has tended to occur when the aviation authorities of one or more countries choose to adopt the standards developed by some other, presumably influential, aviation power. The Federal Aviation Administration's design, production and airworthiness standards, as codified in Title 14 of the Code of Federal Regulations, have in fact been widely borrowed. Until recently, such borrowing took place on a strictly country-by-country basis, with the borrower free to select parts only and to introduce modifications as it saw fit. Apart from its haphazard character, this approach entails the problem that when the parent standards change, as they always do, all states that have borrowed them must follow suit if uniformity is to be maintained. From a more general perspective, too few nations may participate in the process to create an effective world-wide standard. Finally, the airworthiness standards of the state dominant in aviation circles may not necessarily be the best ones available on any given issue.

### 1. Development of the European Joint Aviation Authorities and their Joint Airworthiness Requirements

For these reasons--along with the general aversion that many states feel toward copying foreign country regulations as such--a trend has recently developed in the direction of joint and collaborative standard-setting. Progressively over the past 20 years, 13 Western European nations have deliberately cooperated in the establishment of a structure called the Joint Aviation Authorities (JAA), whose central purpose has been to develop common airworthiness regulations. Current JAA participants include a majority of member states of the European Economic Community (Belgium, Denmark, France, Italy, the Netherlands, Spain, the United Kingdom and West Germany),[81] plus certain non-EEC states (Austria, Finland, Norway, Sweden and Switzerland). To date, the JAA countries have adopted joint airworthiness requirements (or JARs) on different matters. Initially, only France, the Netherlands, the United Kingdom and West Germany agreed to make the JAR standard as such the national standard, the others making the JAR standard optional, so that parties subject to national certification in those states had a choice between meeting the JAR or the national standard on any given issue. More recently, all participating states have agreed to make the JAR provision, once adopted, their sole national standard on the subject.

The scale and timing of JAA cooperation was not at the outset a foregone conclusion. The founders emphasize that the joint rulemaking effort began on a purely exploratory basis, subject from the very start to the condition of technical feasibility in any given case. "The task of ascertaining whether differing national views could be reconciled within an acceptable timescale was initially entrusted to aeronautical engineers having safety as their main objective; only when this appeared feasible were more formal agreements contemplated."[82] From a material point of view too, the JAA began on tentative footings. Its personnel needs and administrative expenses were covered in their entirety by the European aeronautical manufacturers association, AECMA,[83] and by the participating national authorities, and this on a strictly informal basis.

In a decidedly pragmatic spirit, the JAA Steering Committee decided that each JAR, unless dealing with entirely new matter, should be based upon one or another existing national code, the so-called "basic code" for that matter. Nevertheless, the Committee intended that each JAR would reflect the airworthiness state-of-the-art, and that the basic code would therefore serve as a point of departure only, subject in every respect to review by technical study groups, composed of authority and industry representatives, with a view to identifying all desirable additions and modifications.

Intergovernmental work on development of the Joint Airworthiness Regulations began in 1970, with the active support of the AECMA airworthiness committee. By 1974, one joint requirement, JAR-25 (on large airplanes) had been issued. Five years later, that requirement was adopted by four of the JAR countries as the sole code governing large airplanes and in another 4 years the first large aircraft was type-certificated in conformity with JAR-25.

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[81] Non-JAA members of the Community are Greece, Ireland, Luxembourg and Portugal.

[82] Joint Airworthiness Authorities Steering Committee, Joint Airworthiness Requirements: Questions and Answers (1984).

[83] See note 34 *supra* and accompanying text.

There currently exist a JAR-AWO (on all weather operations), a JAR-APU (on auxiliary power units), a JAR-E (on engines), a JAR-P (on propellers), a JAR-22 (on sailplanes and powered sailplanes), and a JAR-VLA (on very light airplane design). Underway or in preparation are a JAR-TSO (on equipment), a JAR 21 (on certification procedures), JAR 23 (on light airplane and commuter design), JARS 27 and 29 (on helicopters), JAR 65 (on certifying staff qualifications), JARS 91(C), 121 (L) and 135(J) (on operations and maintenance), and JAR 145 (on repair stations). On all of these, the expectation is that national variants will be minimal or nonexistent.

## 2. Formalization of the JAA and a Joint Certification Process

The essential framework for JAA cooperation was first set out in writing in an "Arrangements" document dating from 1979, when the JAA had 10 members. The Arrangements expressed a commitment by the signatory states to enforce the airworthiness requirements that might from time to time be mutually agreed upon, and also established certain common procedures for their application to products manufactured in other signatory states. In 1987, the JAA states entered into a more formal "Memorandum of Understanding" on certification procedures, and the following year the Dornier 328 became the first aircraft jointly certificated according to those procedures.

The Memorandum of Understanding formalized the members' commitment to a single airworthiness code eventually shorn of all national variations. On a more strictly procedural level, the JAA states agreed to the establishment of joint multinational certification teams. Besides distributing the costs of regulation among the member states, joint certification ensures acceptance of a certification team's findings by all participating authorities without additional national review. In order to justify this degree of confidence on the part of the various national aviation authorities in the joint certification teams, both the composition of each team and the framework for its activities require approval by the different national authorities. In addition, a system of national coordinators promotes an adequate flow of information between the authorities and the team, once the latter is established. By 1989, joint certification teams had been created for three aircraft (the SF 340B, the MD-11, and the A 330/340) and proposed for three others (the DHC-8-300, the SAAB-2000, and the CN-235). That year Spain became the last JAA country to subscribe to the Memorandum, and an overall JAA certification director was named.

Joint certification represents an important stage in the eventual development of a single European certification process. It is now possible for type-certification of any given aeronautical product to occur virtually simultaneously in the various JAA states, with a reduction in the cost and delay normally associated with multiple design certification. The logical next step is installation of a single European aviation safety agency with Europe-wide type-certification authority.[84] For the forseeable future, however, each national authority remains responsible for the actual issuance of type certificates as well as for the performance of airworthiness certification functions with respect to individual aircraft.

Thus far, JAA efforts have accordingly focused on the joint issuance of airworthiness regulations and on collaborative type certification pursuant to those regulations. Beyond that, the JAA has begun the process of harmonizing the rules governing issuance of production certificates. This initiative is less far advanced and the gathering of needed basic data is still in process.[85] On the other hand, the JAA has advanced considerably the sharing of airworthiness determinations for specific products. A "common release document," otherwise known as an "authorized release certificate," or simply an "airworthiness approval tag," essentially certifies that a particular component part was manufactured in compliance with the applicable regulations of the country stated in the certificate. Where the special requirements of an importing country have been notified to the country of manufacture, the latter's "tag" may certify that those regulations likewise are met. The common release document also may be adapted for used parts, in which case the certificate will state that the repair or maintenance work described was performed in accordance with the regulations of the stated country (and again, where applicable, also in accordance with the special requirements of an importing country) and further that the parts are "in condition for safe operation and considered ready for release to service." At the present time, each European authority has its own "tag;" harmonization of forms will facilitate their mutual recognition.[86]

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[84] The JAA states obviously do not comprise the whole of Europe or even of Western Europe. In 1988, a JAA working group was established to develop the JAA's relations with the preexisting and larger, but substantially weaker European Civil Aviation Conference (ECAC), which has a current membership of 22.

[85] See Koplin, *supra* note 36, who reports that most countries require national approval both of the manufacturer as such and of the manufacturer's issuance of conformity documents.

[86] The United States has recently become involved in this cooperative effort. For years, the FAA used a Form 8130-3 tag for export of aircraft parts. Upon complaint by several JAA countries that the small size of the tag made it difficult to include all the information they deemed necessary, the FAA has met with representatives from the United Kingdom, France, Germany, the Netherlands, and Sweden to develop a mutually acceptable common document. Form 8130-3 was the basis of their discussions and a newly formatted document has been designed, the instructions for which are contained in FAA Action Notice 8130-20.

## 3. JAA Organization

As its functions have developed, the JAA has assumed a more elaborate organizational structure. Its functions are performed by the JAA's directors-general (DGs), one per member state, though most decisions as a practical matter will be made by the Airworthiness Authorities Steering Committee (AASC), otherwise known as the JAA Committee, or management committee, likewise with one member per state. Many of the Committee's functions in turn are delegated to an Executive Board consisting of representatives from France, Germany, the Netherlands, the United Kingdom and a fifth rotating state (currently Sweden). A JAA Secretariat provides the Board with administrative support.[87]

The JAA staff is divided into several divisions whose respective directors report to the JAA Committee and its Executive Board. The regulation division is responsible for fashioning JAA airworthiness standards, and to that end is assisted by technical study groups organized according to the particular regulation (JAR) in need of change or development.[88] JAA certification activities are entrusted to a certification division organized, as seen, into teams according to aircraft type requiring certification. A project certification manager (PCM), assisted by a variable number of local and foreign specialists, heads each team. Two further JAA divisions--one for maintenance and one for operation--have been created or are under contemplation. The five-member Maintenance Committee, assisted by representatives of European manufacturers, operators and pilot groups, is responsible for developing a maintenance code "based upon the current European regulations system, taking into account wherever possible the American regulatory system,"[89] and for identifying significant national discrepancies with that code. The contemplated Operation Committee, charged with developing codes for approving and supervising commercial operators, considers the Federal Aviation Regulations (particularly FARs 121, 125 and 135) to be their point of departure.

Apart from the functional divisions just described, the JAA Committee maintains formal links, in the form of joint boards (JBs), with existing organizations of operators and manufacturers of aircraft. These Boards are in effect standing mechanisms for JAA consultation with interested groups like

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[87] The JAR Secretariat is provisionally located at U.K. C.A.A. headquarters at Gatwick, near London.

[88] Existing study groups include an administrative group, very light aircraft group, engines and propellers group, JAR 22 group on sailplanes and powered sailplanes, various JAR 25 (large airplane) groups, helicopter group and equipment groups.

[89] See Koplin, *supra* note 36. The FAA regulations that are currently being used as the JAA maintenance models are FAR 65(D & E), 91(C), 121(L & V), 127(I & P), 135(J) and 145.

AECMA, AEA (the European airlines' association), and Europilote (the pilots' association). A Joint Assembly affords the JAA a forum for the widest possible discussions and consultations with representatives of manufacturers, operators and pilot organizations.

As previously suggested, airworthiness regulation is not at present a function of the European Economic Community, and its conduct takes place entirely outside the Community framework. The participating states cooperate on a strictly intergovernmental basis, and a given JAR standard, once adopted, becomes a national standard only as and when each state takes the necessary legislative or regulatory action. By 1992, it is hoped, those JAA participants that are members of the Community will share a single certification authority and those EEC states not as yet participants in JAA--Greece, Ireland, Luxembourg and Portugal--will have joined it.

## 4. U.S. Attitudes toward JAA Development

The United States is not and cannot be a member of the European Joint Aviation Authorities, but it has encouraged the organization's development and worked closely with it. Much the same may be said of Canada and Australia. These countries have several reasons for supporting and involving themselves in the European joint airworthiness effort. First, if American, Canadian and Australian enterprises intend to produce and sell aeronautical products on the European and international markets, or operate those products, they necessarily have an interest in the adequacy and feasibility of the European standards and the cost of compliance with them. Economic realities give third countries, particularly those with an active aeronautical manufacturing industry, a strong derivative interest in the JAA process. As for American industry, 60 percent of the world-wide market in aircraft lies outside the United States. It is true that the existing Federal Aviation Regulations provided the basis for many of the JARs, but neither was that a foregone conclusion nor is that invariably the case. As noted, for example, JAR 25 on large airplanes originated from the parallel FAA provision, but JAR 22 on sailplanes was based directly on the German national standard, and the JARs on engines (JAR-E) and propellers (JAR-P) on the applicable British provisions. The JAR-AWO provision was newly developed, though influenced by an existing FAA advisory circular on all-weather operations.[90]

In the second place, non-JAA governments have an independent interest in an efficient, well-functioning international regime, particularly in a field like civil aviation. Standards adopted over as large and economically important an area as Western Europe simply cannot be ignored by other countries in developing their own standards and in protecting local industries upon which prevailing airworthiness standards will have an impact. Earlier sections of this report clearly demonstrate the difficulties that discrepancies in airworthiness standards present for the free movement of aeronautical products in international trade.

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[90] Koplin, *supra* note 36, at 2-3.

American regulators cite yet a third rationale for their involvement in JAA activities. The FAA has found its European counterparts to be highly knowledgeable in technical aspects of airworthiness regulation. They are in any event necessarily in close contact with some of the world's most sophisticated aeronautical product manufacturers. Though under no duty to conform to the emerging JAR standards, American regulators believe they stand to learn a great deal from the Europeans, or at least from consultation and collaboration with them.

The FAA's interest in joint airworthiness regulation with other countries is now in the process of extending beyond Western Europe. The Soviet Union in particular has a fully mature set of aircraft certification standards (Civil Aviation Regulations, or CARs) and an established aircraft certification system (GAR). The FAA's Aircraft Certification Service has initiated contact with its counterpart in the Soviet Union, the Aviation Registry under the State Commission for Flight Safety, to work toward harmonization of aircraft certification standards and practices, and to determine the feasibility of a bilateral airworthiness agreement between the U.S. and the U.S.S.R. The FAA has in fact accepted applications for FAA type certification of both the Tupolev TU-204-200 and the Ilyushin IL-96M, both to be powered with Pratt and Whitney engines. FAA will proceed with these projects in cooperation with the Soviet Aviation Registry as the only credible way to evaluate the Soviet system for aircraft certification. Type certificates will only be issued after a decision is reached by both governments to conclude a bilateral airworthiness agreement.

The FAA has also been working with its counterpart in the Peoples Republic of China toward the conclusion of a bilateral airworthiness agreement. China operates many U.S.-manufactured airplanes, and McDonnell-Douglas MD-80 airplanes are being assembled in Shanghai.

The aircraft certification authorities of both the Soviet Union and China have begun to participate as observers in the FAA/JAA harmonization effort meetings.

## E. Investigative Cooperation

I have previously described compliance aspects of the FAA's airworthiness and operations activities as outside the scope of this study. It is nevertheless worth pointing out that FAA enforcement guidelines contemplate cooperation with foreign aviation authorities in these respects. Apparent violation of foreign aviation regulations by FAA certificate holders or U.S. citizens may come to the FAA's attention in any number of ways, including directly from foreign aviation authorities. The FAA regional office having geographic responsibility for the country filing the complaint investigates the matter and ultimately reports back to the foreign aviation authority through the FAA Office of Chief Counsel and, if need be, the U.S. foreign service post. If the FAA needs to perform investigations abroad, it will seek permission from the foreign aviation authorities and coordinate its activities with the U.S. foreign service post in that country.[91]

Conversely, foreign persons may commit apparent violations of FAA regulations, though this appears to be extremely rare. Such violations would be investigated and reported in the usual manner. Should it need to obtain evidence through a foreign government, the FAA investigative office would consult the FAA regional office having geographic responsibility for the area and the relevant U.S. foreign service post. The regional office would process an enforcement report, either through counsel in the region or (where the respondent is in the service of a foreign company or air carrier) through the FAA Office of Chief Counsel. Agency counsel, in consultation with the relevant FAA aviation standards office and the FAA Office of International Affairs, would determine whether enforcement action in this country is appropriate or whether the complaint should be referred to the foreign government instead.[92] If a violation should directly implicate a foreign government, the Office of Chief Counsel would call upon the Department of State to notify the foreign government and, to that end, furnish it a factual and legal summary, a copy of the investigative report, and a request to be advised of action taken by the foreign government.

## VI. Harmonization Activity: FAA Practice in Negotiating Airworthiness Standards with the European Joint Aviation Authorities

The previous section of this report described the engagement of the European Joint Aviation Authorities in development of common national certification standards and practices. For the set of reasons indicated, the FAA has determined that American participation in that process would be distinctly in the interest of the United States. The present section of the report discusses the establishment and conduct of that relationship.

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[91] FAA Order 2150.3A, Compliance and Enforcement Program (Dec. 14, 1988), secs. 502, 1003(b).

[92] *Id.*, secs. 503, 1003(c).

## A. The Establishment of Contacts and the Decision to Initiate Consultations

The collaborative relationship between American and European aviation regulators has been fueled by considerations of enlightened self-interest in virtually all quarters. Although patterns of collaboration have by now become established and even institutionalized, it is still possible to reconstruct how they came to be. The Europeans themselves, looking for a common regulatory basis for joint European action and finding none among themselves that was both technically and politically acceptable, provided much of the impetus. The JAA thus decided to take existing FAA regulations as their point of departure for the gradual development of European counterparts. The conscious patterning of JAA after FAA material extends even to the numbering of regulations--JAR numbers generally parallel existing FAR numbers on any given matter--and to their wording.

As might have been expected, the JAA carefully avoids any appearance of slavish imitation of American regulatory design. A convergence rather than copying of views is the JAA's stated objective:

> For rulemaking we have a general objective: to have the joint airworthiness requirements as close as possible to the federal aviation requirements. That can be done by making JAR identical to FAR or to persuade FAA to join our JAR view.[93]

As a matter of drafting, the JAA has followed the practice, whenever designing a JAR on the basis of an existing FAR, of beginning with the FAR text, editing it as required and underlining the divergences if any for easy comparison.[94] The practice extends to the adoption of procedural regulations as well. When the JAA Regulation Committee Working Group on JAR 21 decided in 1988 to develop administrative codes for type certification of European products and for products imported from outside Europe, it initially read and reviewed the entire FAR 21 as it then stood. It then determined provisionally that certain "minimum variations" from the wording of FAR 21 would be necessary. Within 18 months, the working group was able to circulate publicly a proposed JAR 21 that differed only slightly from the American text and whose differences from FAR 21 were clearly indicated.[95]

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[93] Koplin, *supra* note 36, at 10.

[94] In order to facilitate a commonality of language and format in FAA and JAA helicopter airworthiness standards, the FAA Rotorcraft Directorate furnished the JAA Helicopter Airworthiness Study Group (HASG) with IBM-PC-compatible diskettes on Word Perfect software containing the current presentation of FARs 27 and 29. The goal was "a FAR-compatible JAR."

According to a former JAA chair:

> It is not our aim in Europe to establish a system for splendid isolation. We know that aviation safety is an international challenge and that it can only be achieved through international cooperation. Our system in Europe is open to all interested authorities and institutions. We have established a world-wide comment system through the subscribers of our requirements. With FAA, we have a very tight and very intensive cooperation. The reasons are obvious; we use your U.S. rules and regulations as a basis, we have extensive ex- and import of aeronautical products and bilateral airworthiness agreements that make cooperation absolutely necessary.[96]

The FAA and JAA have now agreed to initiate discussions with one another before making any changes in airworthiness regulations that would introduce discrepancies with the standards established by the other.[97]

## B. Putting Consultation on a Regular Basis: The Framework for U.S. Participation in European Joint Aviation Regulation

Once the JAA decided on a course of conscious regulatory parallelism with the United States such as described above, a framework for continuing dialogue had to be established. At present, the FAA and JAA hold joint annual policy meetings for the discussion both of general policies and of more or less specific work programs that have been the subject of smaller and more specialized bilateral working groups meeting throughout the year. These annual sessions alternate between Europe and the United States--for example, the 1990 meeting took place in San Francisco and the 1989 meeting in Bordeaux--but the working groups meet periodically as, when, and where the circumstances suggest with much accomplished through telecommunications.

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[95] Joint Aviation Authorities, Joint Aviation Requirements JAR-21 (Draft). The draft also indicates where criteria are expected to be changed on the basis of further discussions and coordination with the FAA or information supplied by the FAA. Discussions between the FAA and the JAR-21 Working Group were held in February 1989 (Gatwick, England), June 1989 (Bordeaux) and March 1990 (Atlanta).

[96] *Id.*

[97] Minutes of the Open Session of the 6th FAA-JAA Meeting, Bordeaux, France (June 1989), item III.

The joint annual meetings are divided into sessions reserved to "the authorities"[98] and sessions open to industry, operators and other interested groups including the press. The former often provide the opportunity for European and American authorities to arrive at common preliminary positions that can then be presented in more or less joint fashion at the "open" sessions which are themselves jointly presided by the two sets of authorities. The annual meetings understandably also provide an opportunity for the working groups referred to earlier, which are composed both of "authorities" and private sector parties, to pursue and at intervals present their findings or recommendations. For example, at a recent annual meeting, the FAA and JAA were jointly briefed on water ingestion problems by a study group actually headed by a committee of the Aerospace Industries Association with a view to eventual changes to air traffic control weather avoidance guidelines.[99] Thus, a striking feature of the FAA/JAA relationship is its continuity. In effect, the annual meetings are only formal plenary sessions, significant less for the official decisionmaking that takes place on those occasions--actually little does--than for the opportunity to exchange views and report progress made in smaller joint industry/authorities gatherings throughout the year. Moreover, an early agenda item at each joint annual meeting is a follow-up report on actions and conclusions reached at the previous annual meeting.[100] To facilitate communications with the JAA, the FAA has appointed at FAA headquarters an individual specifically designated as "entry point" for all JAR-related issues.[101]

Among the most interesting trends over recent years is the development of a pattern of collaboration between American and European industry groups paralleling the collaboration between the FAA and JAA. The joint annual meetings offer settings at which industry on both sides of the Atlantic may effectively present its views to the regulators. This opportunity in turn provides an incentive for industry representatives from both sides to meet periodically throughout the year to discuss common problems and arrive at common positions vis à vis the regulators. At the June 1990 joint annual meeting in San Francisco, for example, the Aerospace Industries Association (AIA), the General Aviation Manufacturers Association (GAMA), and their European counterpart, AECMA, themselves made a joint presentation on aviation noise issues. In that presentation, these manufacturing groups strongly urged (1) the harmonization of existing FAA (FAR 36) and JAA noise standards, (2) the adoption of ICAO Convention Annex 16 and its associated technical manual as the basis of such a harmonized standard, (3) uniform interpretation of the standard adopted and uniform application of equivalences, and (4) agreement on flight testing, noise certification and other compliance procedures and appeals.[102] At the previous annual meeting in Bordeaux, European and American industry worked jointly to eliminate differences between the FAA and JAA on flight test requirements and to that end formulated petitions for proposed rulemaking to the FAA and for parallel action by the JAA.[103] And at San Francisco, industry expressed joint support for the development of common standards for derivative aircraft and for the establishment of uniform maintenance record requirements.

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[98] These sessions are "closed" to the interested parties and the media so as to foster an uninhibited expression and exchange of opinions. Minutes of the Closed Session of the 6th FAA-JAA Meeting, Bordeaux, France (June 1989), p.6.

[99] Overview of the Aircraft Certification Regulatory Program (and associated guidance material) prepared for Federal Aviation Administration and Joint Aviation Authorities Meeting (San Francisco, June 12-15, 1990) [hereinafter "Overview"], p. V-4.

[100] See, for example, "Follow-up of Actions and Conclusions of the 6th FAA-JAA Meeting--Open Session--Bordeaux, June 1989," presented at the 7th FAA-JAA Meeting, San Francisco, June 1990. Carryover agenda items included aging aircraft, derivative aircraft, tuned gust, fatigue testing, cabin safety and a variety of specific harmonization efforts.

[101] The Aircraft Certification Service also has an office in Brussels.

These are not isolated examples. When it became apparent at Bordeaux that the FAA and JAA intended to harmonize their respective engine airworthiness standards, European and American industry determined to have significant input into the process. The AIA's Propulsion Committee accordingly formed a subcommittee (comprising representatives of all major American and Canadian engine manufacturers) to organize that effort by intially calling a joint meeting in Paris among the JAA, FAA, AIA and AECMA. The AIA subcommittee then sought in cooperation with AECMA to establish a common industry position on the 20 items that the FAA and/or JAA had identified as possible additional engine conditions. The AIA was thus able to present formally to the authorities in San Francisco a fully joint industry position on those matters.[104] Similarly, GAMA took that occasion to express formally to the FAA and JAA the joint industry view that the safety record of commuter airplanes did not justify adoption of more stringent airworthiness requirements for that category of aircraft.[105]

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[102] AIA/AECMA/GAMA Presentation on Noise Issues at the Seventh FAA/JAA Meeting, June 13, 1990, San Francisco, California.

[103] Position on Conclusions and Actions at 9 April 1990 of 6th FAA-JAA meeting (Open Session), Bordeaux, June 1989.

[104] Statement of Paul Meyer, AIA FAR 33/JAR-E Harmonization Committee, to the 1990 joint FAA/JAA annual meeting in San Francisco.

The FAA and JAA strongly support the concept of concerted industry activity on standards research and development. One can well imagine that the authorities would perceive an advantage in presenting a united regulatory front to a nationally divided industry. However, the FAA and JAA alike have stated and acted on the view that it is in the regulators' long-term interest to know the industry position, if indeed there is one, and to be able to deal with industry as a more or less unified group.

As these examples suggest, FAA/JAA collaboration (and related collaboration between American and European industry) concerns substantive technical matter, often in the form of standards to be newly adopted, modified, borrowed or harmonized. To date, most collaboration has related to aircraft certification standards, but has now extended to operations and maintenance as well.[106] No less interesting from a legal point of view, however, are the exchanges of view that take place between the authorities (as well as with industry) on issues of certification procedure. Among the matters treated at the Bordeaux annual meeting, and subject to follow-up reported at San Francisco, were procedures for manufacturers' appeals against adverse decisions taken in their regard by the JAA. The steps eventually taken were fully discussed in draft at joint meetings of the FAA and JAA, in which industry participated.

The aircraft certification authorities and industry representatives from Canada, Australia, China and the Soviet Union have participated as observers on joint invitation from the FAA and JAA.

An earlier section of this report emphasized that regulatory cooperation between national aviation authorities has been fueled in large measure by a mutual desire to increase the opportunities for cooperation in airworthiness enforcement, in particular the sharing of design certification functions. It is not surprising, therefore, that the increase in regulatory harmonization between the FARs and JARs has been accompanied by more concerted certification efforts. A good illustration of the latter is the recent Memorandum of Agreement between the FAA and JAA on the delineation of responsibilities for certification of the McDonnell Douglas MD-11 airplane.[107] Pursuant to this agreement, whose primary objective is "to define the working procedures under the respective responsibilities and to foster a greater understanding of the MD-11 certification issues and concerns between the FAA and JAA and [thereby] strengthen relationships to minimize differences in aircraft certification standards,"[108] the FAA and JAA each assumed distinct responsibilities with respect to the MD-11 design certification process. The JAA undertook to notify the FAA in writing of any JAA requirements beyond those of the FAA, to indicate for which of those the JAA would make its own inquiry, to furnish all relevant JAA regulations and interpretive material with respect to the others, and to notify the FAA of any FAA test it wished to witness. For its part, the FAA undertook to satisfy itself and report formally to the JAA as to the craft's compliance with the FAA certification basis plus the additional JAA requirements as notified by the JAA. The agreement further specifies communication routes between the FAA and JAA respecting the MD-11 certification.

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[105] General Aviation Manufacturers Association, Commuter Category Airplanes: Industry Views (presentation at Seventh FAA/JAA/Industry Meeting, June 12-15, 1990, San Francisco).

[106] Cooperation in operations and maintenance standards has become vital on account of the growth of international aircraft leasing. Through such leasing, a plan may operate out of state for long periods making it unworkable for the state of registry to perform its regulatory functions with respect to that craft. A proposed article 83 bis of the Chicago Convention would provide a legal basis for the formal transfer of maintenance and operations responsibilities to the leasing country. Until it is ratified by the required number of countries (98), the only way to delegate responsibility is through informal understandings. As in the certification area, those understandings can be effectively implemented only if there is a fair degree of commonality in aircraft operations and maintenance standards and procedures. See remarks of Admiral James B. Busey, FAA Administrator, at 7th FAA-JAA Meeting, San Francisco (June 1990).

## C. Agency Information-Gathering about Foreign Regulatory Activity and its Domestic Impact

It should be obvious from what has thus far been said, that the FAA does not rely on happenstance to discover the regulatory and technological developments occurring in European aviation circles. Gathering basic information of that sort is essential to the FAA's efforts to assess the impact of regulatory or technological change abroad on American regulatory and economic interests. The establishment of an information network in other regulatory domains may turn out to be more difficult in operation and less perfect in result than has been the case for civil aviation regulation. The relatively easy access to European developments enjoyed by the FAA may be explained in part by the Europeans' candid acknowledgment of our traditional preeminence in both regulatory and technological aspects of civil aviation, and their collective judgment that a full, timely and cooperative-spirited exchange of information was decidedly in their interest. It is nevertheless likely that the same situation obtains in other regulatory sectors where systematic cooperation with foreign authorities offers promise.

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[107] Memorandum of Agreement of April 9, 1990 between the FAA (Transport Airplane Directorate) and JAA.

[108] *Id.* The agreement further recites as objective "to minimize redundant inspections, tests, demonstrations, evaluations, and approvals."

In any event, a full mutuality of information seems to depend upon two circumstances in particular. The first is the development of a generally common regulatory agenda. The more or less formal and regular contacts between the FAA and JAA described earlier help ensure that at any given time both sets of authorities are addressing parallel regulatory and technical problems. The second element favoring mutual access to information on current developments is a more purely operational understanding that research, study and recommendation generally speaking will be undertaken by joint working or study groups, on which, as has been seen, private sector interests on both sides likewise may be represented. For example, a joint Cabin Safety Group chaired by a high-level British aviation regulator recently has been seeking to identify significant cabin safety problems in civil aviation and to find their solution. While this particular group is technically composed of JAA members only, it in fact works closely with the FAA and Canadian authorities, which have in effect become part of the process. Other areas of research and development--for example, aging aircraft, smoke hoods, powered-lift standards, water spray technology and electromagnetic emission shielding--are all matters of current joint FAA/JAA inquiry.[109]

A particularly productive area of collaboration was in the development of a rule for rejected take-off performance for transport aircraft. As a result of successive meetings among FAA and JAA technical staff and European and American manufacturers and pilot groups, a solution is under development that will be satisfactory to both sets of regulatory authorities. Implementation in the United States will require modification of FAR 25.[110]

## D. Techniques for Communicating U.S. Agency and Private Party Views to Foreign Authorities

When matters pass from the study to the action phase, the JAA routinely notifies the FAA of all notices of proposed amendment (or NPAs), as the Europeans call their nearest equivalent to our notices of proposed rulemaking

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[109] *Id.* As to the last field mentioned, the FAA and JAA have jointly developed common standards for the protection of aircraft electrical systems from the effects of high intensity radiated fields (HIRF).

[110] See Remarks by Admiral James B. Busey, FAA Administrator, in Notes of Seventh FAA/JAA Meeting, San Francisco, California (June 12-15, 1990), p. 2.

(NPRMs). NPAs are formulated by the JAA Joint Steering Committee,[111] upon the advice of one or more JAA technical study groups. In all likelihood, the content of these NPA's will come as no surprise to the FAA as it will have sprung in whole or in part from prior consultations. But the notices do serve as a formal reminder that JAA action in the nature of an amendment to the JARs is about to be taken and that final FAA comments are still welcome. When the JAA recently issued an NPA on the subject of tuned gust, it notified the FAA as well as industry and held meetings jointly with both. Following final comments, the NPA will be sent again to one or more JAA technical study groups for reconsideration and report to the Joint Steering Committee for eventual acceptance or rejection.[112] On the tuned gust subject, the NPA process eventually resulted in rule changes acceptable to all parties.[113]

Among the clearest signs of the openness of channels between the FAA and JAA is the latter's practice of entertaining for adoption any amendments that the FAA actively considers introducing into the Federal Aviation Regulations. The JAA has thus shown its aversion to allowing unintended disparities between the JAR and any parallel FAR that may exist. This spirit of conscious parallelism does not necessarily ensure agreement between the FAA and JAA. However, where agreement cannot be reached, the JAA has adopted the practice of publishing an underlined version of the JAR to facilitate comparison with its American counterpart and the identification of differences. (For an illustration, see Annex B to this report.)

The scale of collaboration between the FAA and JAA is manifestly the result of the latter's conscious desire to build its developing airworthiness standards upon existing FAA regulations, while at the same time enlisting FAA interest in modifications that the JAA deems advisable.[114] Although the

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[111] The Joint Steering Committee consists chiefly of representatives of the civil airworthiness authorities of the participating countries, plus representatives of the manufacturing industry, operators and pilots. See Joint Airworthiness Authorities Steering Committee, Joint Airworthiness Requirements: Questions and Answers (1984).

[112] JAA rulemaking procedures are set out in Administrative Procedures concerned with the Production and Amendment of the Requirements (Printing & Publications Services, Greville House, 37 Gratton Road, Cheltenham, Glos. GL50 2BN, U.K.).

[113] Follow-Up of Actions and Conclusions of the 6th FAA-JAA Meeting--Open Session--Bordeaux, June 1989. An NPA on crashworthiness and seat configurations has also been subject to discussion in joint FAA-JAA gatherings.

[114] On certain matters still under research and development, the JAA has consciously decided to allow the FAA "to carry the ball" and to participate only marginally at the R&D stage. Such is the case, for example, with powered-lift standards for rotorcraft. Notes of 7th FAA-JAA Meeting, San Francisco (June 12-15, 1990), p. 36. The reasoning is that on relatively noncontroversial matters, or at early information-gathering stages, it is more economical for one set of authorities to "take the lead" in rule development.

FAA has responded enthusiastically to these overtures, it understandably has not had the same incentive to conduct a reciprocally comprehensive review of European airworthiness standards. Thus, the JAA's more or less systematic examination of the Federal Aviation Regulations has not quite been matched by a parallel FAA review of all the JARs currently in effect. Such review might offer an additional opportunity to identify regulatory dissonance between the European and American authorities.

## E. American Preparation for International Airworthiness Consultation

Although previous knowledge of a foreign regulatory system and its practices seems a perfectly obvious aid to productive collaboration with the foreign authorities, the point has received special emphasis from all participants in the process, American and foreign alike. For example, Claude Frantzen, of the French Direction générale de l'aviation civile (DGAC), insisted on the necessity of "a complete knowledge and understanding of the regulations of the other party, [which] implies a heavy and long term investment in learning languages...and getting familiarized with their culture."[115] Not every American regulatory agency may be prepared to make the investment alluded to, and that investment may not in the case of all agencies be sound. Nevertheless, the relationship of that investment to results achieved by the FAA is unmistakable.

In the case of Craig Beard, the FAA's director of the Aircraft Certification Service in Washington had spent several years at the agency's European office and was professionally and personally acquainted with his European counterparts and their practices. That no doubt had something to do with his commitment to placing European and American regulatory cooperation in aviation matters on a institutionalized footing. His personal interest in expanding the scope of the FAA's international aircraft certification activities has since brought the agency into contact with authorities in Asia, South America and Eastern Europe. On the other hand, the interest and inclination of one person alone are not sufficient to sustain a program of cooperative regulatory activity. In the case of the FAA, that interest and inclination came to infiltrate the agency's total Aircraft Certification Service, with each FAA regional certification chief personally engaged in cooperation with the JAA regulatory apparatus under the leadership of that person.

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[115] Letter of October 16, 1989, from C. Frantzen to G.A. Bermann.

## F. Caveats about Direct International Agency-to-Agency Influences

### 1. Problems of Language and Meaning

Although difficulties arising out of differences in language and meaning are hardly unique to the international civil aviation field, they are present. The experience of the FAA Aircraft Certification Service in dealing with European counterpart agencies offers good illustrations of the sort of difficulties that may be encountered.

The best way to avert or minimize these sorts of difficulties is to acquire a sensitivity to the circumstances in which they are likely to arise and to adopt specific practices designed to reduce their incidence. For instance, the FAA and JAA have found it useful to employ the same terms and the same format when inscribing agreed upon matters within their national regulations and to keep national reformulation to a minimum if not eliminate it altogether. As one participant in the process has observed, "any rewriting...leads to 'minor' differences which later create real (and not minor) difficulties."[116]

An identity of texts does not, however, ensure an identity of interpretations. As the manufacturer of the Boeing 747 sought to comply with JARs that were based on the same language as preexisting FARs, it found that the Europeans were interpreting that language somewhat differently. Good examples of the differential meaning of shared language are the terms "new" and "derivative" aircraft. As much as anything else, industry preference for an orderly and unambiguous regulatory environment has prompted FAA and JAA efforts to reach a single understanding of shared language. Those efforts understandably involve dialogue between national authorities and a mutual willingness to seek clarity and occasionally to compromise.[117]

As for the resolution of misunderstandings that do arise, there is no single remedy. In the narrow context of the bilateral airworthiness agreements, the accepted rule, in case of ambiguity in a country's laws, regulations or requirements, is to adopt the interpretation of that country.[118] This not only makes sense, but is central to justifying the full faith and credit that importing states under such agreements are asked to give to the findings and conclusions of exporting states. Of course, a precondition to any effective international communication in the regulatory arena is accurate and up-to-date information by each country of the other's regulatory criteria in force. Accordingly, bilateral airworthiness agreements commonly impose an obligation of mutual notification of regulatory change.[119]

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[116] *Id.* JAA documents and discussions are generally in the English language. For most of the JAA countries, however, regulations and other documents must ultimately be enacted in the jurisdiction's official language or languages.

[117] Industry representatives repeatedly emphasize the importance of consistent interpretation and application by national authorities of their common standards. Minutes of Open Session of FAA/JAA Meeting, Bordeaux, France (June 1989), item III.

[118] A typical bilateral airworthiness agreement clause reads: "In the case of conflicting interpretations of the laws, regulations or requirements pertaining to certifications or approvals

## 2. Problems of Style

In matters as substantively complex and technical as airworthiness regulation, matters of regulatory style are bound to play a relatively minor role. Nevertheless, it is useful to point out the possibility that different national regulatory establishments also may take somewhat different regulatory approaches, and that these differences may on occasion be productive of misunderstanding.

Conversations with JAA officials suggest that the European authorities generally favor a better organized and more systematic approach to regulatory drafting, and accordingly strive for a degree of comprehensiveness and structure that is quite foreign to American regulatory practice. The JAA's pronounced willingness to take the existing FARs as a regulatory point of departure has served to mask considerably the extent to which they naturally favor a more code-like methodology. In fact, some of the differences that have arisen in FAA/JAA harmonization efforts may be explained by the Europeans preference for a complete and orderly regulatory framework. For their part, the Europeans have had to deal with a relatively unfamiliar tendency on the FAA's part to target problems on a decidedly concrete basis with an emphasis on narrow solutions to reasonably well-focused problems.

My impression is that these stylistic differences can easily be exaggerated, that they do not loom especially large in highly technical fields like airworthiness regulation, that the preeminence of the FARs has given the American approach a decided edge, and that the authorities on both sides have shown a marked capacity to bridge what are at bottom relatively inconsequential differences of style. The FAA and JAA share both a strong sense of programmatic purpose and a sensitivity to function. These in turn

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under this Agreement, the interpretations of the aeronautical authorities of the Contracting State whose law, regulation or requirement is being interpreted shall prevail."

[119] Accordingly, bilateral airworthiness agreements typically provide that "[t]he aeronautical authorities of each Contracting State shall keep aeronautical authorities of the other Contracting State currently informed on all relevant laws, regulations, and requirements in their State."

lend their efforts a powerfully pragmatic flavor and better serve the public interest in promoting aviation safety.

## 3. Defining "Foreign" for International Regulatory Purposes

To the baseline difficulties of language and meaning in any international communication situation must be added the problem of defining terms such as "foreign," "country of production," or "place of manufacture" that recur in this regulatory setting. The latter problem itself is heightened by the international realities of the industry itself that is being regulated. Take again, for example, the bilateral airworthiness agreements under which certification services performed by the authorities of one country may be conclusively relied upon by the authorities of another for product import purposes. The agreements typically refer to production in one country for export to another. However, many aircraft and appliances consist of component parts or subassemblies originating in several countries. Prominent examples include the Boeing 747, McDonnell Douglas DC-10, Lockheed L-1011, Concorde, and Aerospatiale A300B Airbus. For the sake of regulatory simplicity, the FAA traditionally has considered the country of production to be the country where units of the product first come together as end units, are tested as such for certification purposes, and receive their first approval by a recognized airworthiness authority.[120] Certain segments of the manufacturing industry have complained that this practice thwarts their preference for postponing final assembly and flight testing of a product until after its export in an unassembled condition, because it requires post-testing disassembly for export and consequently retesting upon reassembly abroad. Moreover, the definition of country of production requires that even component parts manufacturers in the importing country must ship those parts to the country of aircraft manufacture for the final assembly and flight test required for export certification. The components then may well be removed for reshipment along with the disassembled aircraft for later reassembly. These scenarios illustrate the problems of squaring regulatory simplicity, on the one hand, with changes in market realities (notably the emergence of multinational products) that the regulated industries are facing, on the other.

Problems of classification have become still more acute with the emergence of multinational joint ventures in the aeronautical manufacturing field, typified by the International Aero Engines Model V-2500 engine. Where true joint ventures are concerned, the term "country of manufacture" can lose meaning altogether. In the joint venture situation, the FAA and its foreign counterparts now deliberately determine and refer to a "country of prime accountability" for the regulation of product design, production quality, and the airworthiness of completed products.[121]

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[120] FAA, Export/Import Airworthiness Certification of Civil Aeronautical Products, FAA-P-8110-1 (May 15, 1987), p. 24.

## G. The Inter-agency Dimension: Consultations with the Departments of Commerce, Labor, State, and Transportation and the Office of U.S. Trade Representative

Because of its obvious international trade and foreign relations implications, the FAA's airworthiness certification operations may be of interest to other federal agencies. Consultation with other agencies is most obviously in order at points where the federal government enters into binding international engagements. Thus, our membership in the International Civil Aviation Organization (ICAO) came about as a result of the negotiations conducted by the State Department at the Chicago Conference of 1944. The United States is today represented at ICAO meetings at all levels by officials of the Department of Transportation, including the Federal Aviation Administration. However, before taking any official position on matters of importance, they will report to the Interagency Group on International Aviation (IGIA), which, as mentioned above, consists of the principally interested executive branch departments and agencies: Commerce, Defense, Labor, and State, and the Office of U.S. Trade Representative.

Similarly, whenever a foreign government requests the conclusion of a bilateral airworthiness agreement with the United States, or requests that an existing agreement be revised, the FAA submits the request, together with any supporting materials, to the interested federal agencies represented in the Interagency Group referred to above. If the initial reaction is positive, the State Department asks the FAA to examine the requesting country's airworthiness certification system to establish the appropriateness of entering into a bilateral agreement with the country or modifying the existing agreement. As noted, the FAA makes determinations about the foreign airworthiness authority's technical competence and regulatory efficacy, the adequacy and completeness of the foreign country's airworthiness laws and regulations, and the state of the foreign industry's design and manufacturing capability, in order to decide whether the country's aviation authorities and industry will be able to perform their responsibilities under a bilateral agreement. The FAA also considers the country's need for an agreement enabling it to export products to the United States, since a proliferation of needless accords is rightly deemed undesirable. Although these determinations rest largely on FAA shoulders, the other agencies, particularly the State Department, are consulted. FAA and State Department counsel jointly negotiate and draft any agreement with their foreign country counterparts. The State Department reserves the right of final review of any such draft. Once approved, the agreement is the subject of an exchange of diplomatic notes between the State Department and its foreign counterpart.[122] Negotiation of a new bilateral normally takes 3 to 4 years, and the amendment of an existing bilateral about 2 years.[123]

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[121] Opening remarks of M. Craig Beard, Director of the Aircraft Certification Service of the Federal Aviation Administration, at the 1989 Annual Conference of the ABA Forum on Air and Space Law, p. 3.

Once this international legal framework is in place, resort by the FAA to the Interagency Group on International Aviation is unusual. Absent some discernible controversy of direct interest to one or more of those agencies, the FAA acts largely on its own. These episodes are rare. One example--the repair stations episode--surfaces later in this report. In another, better-known example, the FAA had decided, in the wake of a major Chicago air disaster involving the DC-10 immediately to ground all such U.S.-registered aircraft pending investigation and to deny takeoff and landing rights to non-U.S. craft of that design. This action, which impaired the functioning of foreign as well as domestic airlines in the United States, provoked a strong negative reaction from the major foreign aviation authorities and eventually the foreign governments themselves. The State Department understandably became involved in negotiations over the duration and continuing necessity of the grounding order. However, the grounding order was not lifted until the FAA satisfied itself that the DC-10 design had no unsafe features.

## VII. The Mirror-Image Question: When and How Do Foreign Governments Participate in FAA Regulation?

Like so many other aspects of the relationship between the United States and Western Europe, influence over foreign regulatory activity no longer travels a one-way street. The FAA's involvement in European airworthiness developments has brought with it a corresponding influence of European authorities over FAA aviation safety policy. This development can best be illustrated by a recent concrete example involving the regulation of helicopter design.

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[122] If a decision is made not to enter into a bilateral agreement, the requesting country receives a written report specifying the reasons and indicating what steps need to be taken to ready the situation. Such a report may become the basis for a technical assistance agreement between the FAA and the foreign country in keeping with the Standards Code referred to earlier.

[123] Sullivan, A Framework for the Development of Compatible Cabin Safety Standards.

## A. The Helicopter Regulations: A Case Study in Bilateralism

In the wake of a series of recent mishaps, Britain, Norway and certain other North Sea perimeter countries recently decided to reexamine safety aspects of the use of helicopters for servicing oil rigs operating in the harsh North Sea environment and eventually adopt appropriate joint airworthiness requirements for those vehicles. These countries individually advised the FAA's Aircraft Certification Service that they did not regard existing FAA airworthiness regulations governing helicopters as sufficiently protective, and that they were not prepared to adopt those regulations as their own unless made more stringent in certain ways.

The FAA responded by notifying those countries--and indeed the JAA, of which they were members--that an updating of the helicopter FARs (in particular, parts 27 and 29) was planned, and by asking them to withhold action until the updating process could be completed. The FAA understandably also sought to know in advance the respects in which the Europeans thought the American helicopter standards inadequate. There ensued a considerable exchange of information, the FAA advising the JAA of its own helicopter safety concerns and of the regulatory changes it was considering to address them. The JAA then offered detailed written commentary, based on the reactions of the various European aviation agencies, both on the existing FAA rules and their prospective reform. The JAA actually formed a joint European study group on parts 27 and 29 to coordinate this effort.

Much of what the Europeans proposed--the Aircraft Certification Service estimates it at 70 percent--proved immediately persuasive to the FAA and became incorporated into a draft proposed regulation that itself eventually became the subject of an FAA notice of proposed rulemaking. The convergence of views, and prospects for still further convergence, were such that the JAA agreed to defer adoption of its own helicopter standards--which at that time still would have differed significantly from the modified American proposal--until the FAA rulemaking procedure had run its course and all opportunities for European influence had been used. During the FAA comment period, the European study group was persuaded that certain changes it had advocated were unnecessary, but still it continued to press for other changes in the proposed FAA rule that would align it more closely with European thinking. In the course of extended discussions at the FAA's Fort Worth office, the JAA countries took a hard line on what they considered the remaining essential safety features missing from the FAA's proposed helicopter rules. The FAA eventually issued an amended notice of proposed rulemaking, incorporating additional but still by no means all recommendations of the JAA. A final rule was adopted in September 1990, but there remained certain discrete points on which the FAA and JAA could not bridge their differences, with the Europeans generally favoring stricter standards. The FAA's position was that it would seek to distinguish among the outstanding points of difference according to the degree of consensus among the individual JAA states, their apparent priority in importance to the Europeans, and of course the strength of the FAA's own informed convictions.

Though not unproblematic, the scenario just described has distinctly positive attributes. It does seem basically useful and appropriate that the FAA work constructively with its European counterparts on regulatory matters of common interest. In the case of civil aviation airworthiness governance, those interests are not only common but, as we have seen, highly interdependent. The unselfconscious willingness of the JAA in principle to build their helicopter standards, and indeed their standards on virtually all other airworthiness matters, on the current Federal Aviation Regulations was an early and enduring sign of genuine good will. However, the impression of some persons in the FAA Aircraft Certification Service is that this attitude on the part of the JAA, and related practices like regular consultation with the FAA on prospective deviations from the FARs, is in part a product of the FAA's own amenability to discussion and compromise.

The helicopter standards episode also shows how difficult it is after all to identify exactly who is seeking to influence whom. When the FAA persuaded the JAA that certain modifications the latter had been seeking to bring to the FARs on helicopter airworthiness were unnecessary, the FAA in effect influenced the JAA's own helicopter rulemaking. The fact is that influence is truly being exerted in both directions.

The importance attached to harmonization of helicopter airworthiness standards is such that the FAA and JAA have recently entered into an express undertaking to pursue that goal. Their "Letter of Intent" to this effect expresses an undertaking to cooperate toward the convergence of standards and advisory materials by January 1, 1993.[124] The agreement commits the authorities to a series of early joint industry/authorities meetings on both the general design and precise wording of further changes needed for development of "a compatible mutual approach." In order to facilitate their dialogue, the FAA and JAA have each designated specific contact persons for each relevant subpart of the helicopter regulations to be harmonized.

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[124] Letter of Intent of March 20, 1990 on Coordination of U.S. FARs and European Helicopter Airworthiness Codes. The agreement arose out of a special meeting in Paris among the FAA Rotorcraft Directorate, the JAA Helicopter Airworthiness Study Group (HASG), AIA and AECMA. See Trip Report dated March 30, 1990, by John J. Shapley and Robert T. Weaver, managers, respectively, of the FAA Rotorcraft Standards Staff and Regulations Group.

The pattern of reciprocal regulator-to-regulator influence had already surfaced in the JAA's first major JAR initiative, namely certification standards for large transport airplanes. The development in the 1970s of new European models, exemplified by the Concorde and later the Airbus, represented an effort by European aircraft manufacturers to enter a lucrative market until then dominated by American enterprise. The American attitude toward the new technology and its regulation was understandably ambivalent. On the one hand, United States manufacturers rightly perceived a threat to their traditional dominance of the market. They also feared that certain of the standards likely to be adopted by the JAA would be tailored to suit the new European entries but not their established American rivals, and thus operate as exclusionary and unnecessary trade barriers. On the other hand, they had to welcome the technological advances brought by this more competitive environment and to concede the necessity of regulating for their safety and for the protection of environmental values.

Much as in the helicopter case, the JAA commenced by borrowing the pertinent Federal Aviation Regulations, in this case part 25. However, the JAA favored certain modifications and, at that time, was prepared to allow national variances among the JAA countries.[125] The FARs and JARs were not then fully identical. Over the next 10 years, as national variances within Europe were gradually phased out, the JAA remained in constant communication with its FAA counterparts about the further regulatory modifications that the technological change and heightened environmental concern common to both sides were causing European and American regulators alike to consider for large transport airplanes. In fact, the FAA Aircraft Certification Service was consulted by the JAA on all regulatory issues arising over the 10-year period, and the JAA participated as such in all the relevant FAA rulemakings. In the result, virtually every significant change made to part 25 during this period was reproduced in the parallel JARs, and vice versa.

As far as appears, this process replicates itself across the broad spectrum of technical issues confronting American and European civil aviation authorities. Both sides acknowledge their interdependence by conferring extensively before making changes of any moment in their airworthiness regulations. Equally important, and by way of anticipation of these changes, they have formed joint working groups to address technical and regulatory problems as they arise and to formulate common solutions. Those having perhaps the most direct interest in a common American and European response to emerging airworthiness problems--AIA, GAMA and AECMA--have done their best to encourage the progressive harmonization of standards as they evolve. By way of a more current example, the JAR 21 group (consisting of French, German and United Kingdom authorities and AECMA representatives) began in 1988 to develop administrative codes for aeronautical products, both domestic and imported. It comprehensively reviewed FAR 21 and within 18 months had produced a proposed JAR 21 that diverged in certain respects from the American version on such technical issues as flammability and gust requirements and collision avoidance systems. Joint deliberations are underway to determine whether some of the provisions the Europeans still would like to introduce into JAR 21 might be agreeable to the FAA and might become the subject of parallel FAA proposed rulemaking.

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[125] At first, only five JAR countries--Britain, France, Germany, the Netherlands and Sweden--adopted JAR requirements as the national standard pure and simple. The other countries basically offered manufacturers a choice between conforming to the JAR requirements or, alternatively, to the existing national standards as modified.

Although the FAA may be unusual in the extent to which it engages and attends to the opinion of foreign country regulators, it is difficult to fault the FAA for openness and responsiveness of that kind. In a field such as civil aviation, the need for international cooperation is evident and a refusal to engage in that process will inevitably prove costly. It will do the American aviation industry little good to secure relatively relaxed safety standards from the domestic regulatory agency when, as a practical matter, its products still must pass regulatory muster with more exacting foreign authorities who ultimately decide what air safety within their jurisdictions reasonably requires.

## B. The Repair Station Episode: Drawing the Line between Unilateralism and Bilateralism

Notwithstanding the basically positive record of the FAA's international certification activities, problems and misunderstandings occasionally have arisen. FAA policy on the use of foreign repair stations for the servicing of U.S.-registered planes provided one such occasion. Under a longstanding FAA regulation, absent an emergency situation, U.S.-registered craft normally could be serviced by foreign mechanics or at foreign repair stations only if the craft were predominantly used abroad. Besides limiting the circumstances permitting foreign repairs to U.S. air vessels ("the scope of work restriction"), the regulation also barred the use of foreign mechanics and repair stations not previously approved by the FAA. An awkward and costly system of certification of foreign mechanics and repair stations was accordingly put into place.[126] In the face of widespread disregard of these rules, the FAA's Flight Standard Service (Maintenance Division) issued a reminder to the airlines and to foreign aviation authorities both of the importance of the rules and of the FAA's intention to enforce them.

This statement of FAA policy on the use of foreign repair stations by U.S.-registered aircraft and on the certification of foreign stations and mechanics provoked a strongly negative reaction by foreign governments and by United States airlines. Both forcefully lobbied for a change in the regulations, and brought the matter to the attention of the Secretaries of Commerce and Transportation and the United States Trade Representative. As demonstrated by the involvement of the USTR, the regulations were depicted as an unjustified nontariff barrier to trade in services, as well as an affront to foreign states, particularly those with which the United States had seen fit to enter into bilateral airworthiness agreements.

The airlines and foreign governments did not particularly take issue with the claim that the FAA, bearing responsibility to third parties for the safety of U.S.-registered craft, had an interest in ensuring the adequacy of repair services wherever performed, though the appropriateness of an FAA certification program for foreign repair stations was not conceded. The focus of complaint was the confinement of foreign repairs to craft predominantly flown abroad, and the FAA eventually sought to eliminate this restriction through FAA rulemaking. In the face of vocal opposition by the International Association of Machinists to the proposed reform, Congress chose, through a rider to the FAA appropriations bill, to bar the FAA for 1 full year from adopting any final rule on the subject. Congress also questioned the FAA's capacity to inspect and certify foreign repair stations under circumstances in which greatly expanded use would be made of those stations. After the year had passed, in November 1988 to be precise, the FAA adopted a final rule eliminating the restriction. The change itself remains under threat of reversal by legislation.

In some respects, this episode illustrates FAA resourcefulness and responsiveness to international aviation realities. However, the Maintenance Division's expression of policy on the use of foreign repair stations came as a jolt to the agency's counterparts abroad and generated deep dismay on their parts. This reaction was due as much to the apparent unilateralism of the FAA position as to the position itself. Moreover, although the prospect of the FAA conducting inspections of foreign repair stations was not received as unfavorably as the scope of work restriction, there is evidence that it too was greatly resented as unduly suspicious of foreign agency know-how and competence in aviation regulation. Had Maintenance Division personnel effectively communicated with their European counterparts, they might have anticipated the foreign reaction and approached the repair station problem differently at the outset. Consideration might also have been given, so far as the adequacy of foreign repairs is concerned, to a system of mutual recognition of repair station certification, a system not as yet embraced even by the bilateral airworthiness agreements with partners in whom the FAA has the highest level of confidence. Arrangements of that sort might avoid the unhappy prospect of FAA inspection and surveillance of foreign installations. Many persons in the FAA regard the repair station episode as a costly one in terms of the FAA's foreign relations and one whose damage itself has been difficult to repair.

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[126] An exception is the regulation, FAR 43.17, permitting maintenance work to be performed on U.S. aircraft in Canada by persons certificated by the Canadian authorities.

A positive result of the foreign repair station episode is that the JAA member countries have begun work on common European standards for aircraft maintenance. Accordingly, the FAA and JAA are now in the early stages of pursuing the harmonization of their maintenance standards and practices, following the aircraft certification model.

## C. FAA Policy and Practice on JAA Involvement in Rulemaking

This report demonstrates how the involvement of the JAA in FAA rulemaking has evolved out of a shared and largely industry-supported interest of the agencies in establishing and maintaining common airworthiness standards. It also illustrates the natural linkage between the commonality of those standards and the feasibility of an international sharing of responsibility for the implementation of those standards through a system of mutual recognition of tests and certificates.

The FAA's borrowing of foreign country certifications takes place within a formal framework of well-established treaty-based bilateral cooperation. The decision when, under what conditions, and to what extent to utilize the enforcement services of a foreign governmental agency inevitably requires the sound exercise of judgment on an agency's part. It also requires continuing review of the technical adequacy of those services and their degree of "fit" with the domestic regulatory operations in which they are enlisted. Provided the necessary safeguards are observed in entering into, implementing and reviewing these administrative arrangements, they do not raise substantial issues of principle.

The involvement of foreign government authorities in the rulemaking process as such raises more delicate questions. Although, as noted, this pattern of involvement is more the product of a natural evolution than of planning, it has reached the point where a statement of FAA procedural policy is in order. The following sections of this report restate basic FAA practices on the solicitation and utilization of foreign regulatory views, and then examine their degree of harmony with the conventional norms of American administrative procedure.

## 1. FAA Solicitation of Foreign Government Views

Habits of rulemaking cooperation between the FAA and JAA have so far developed that it can now safely be said that no notice of proposed rulemaking on design, production or airworthiness certification matters, or related issues, is likely to be issued until the JAA has first had an opportunity to examine what is about to be proposed and been invited to comment. As a European director general half-jokingly remarked at a recent international gathering of aviation authorities, he hoped he had seen the last occasion of unilateral FAR modification, by which he meant modification without prior consultation with the European authorities. To put the matter differently, the JAA has become de facto a privileged rulemaking participant, accustomed to being consulted by the FAA in a systematic fashion and at a distinctly pre-NPRM stage. Only recently, the FAA and JAA agreed that whenever NPRMs and NPAs on the same subject differ, each will call specific attention to the points of difference so as to allow parties commenting on the proposed rule or amendment to take them into account.[127]

In fact, to describe JAA involvement as systematic and pre-NPRM would be to underestimate the thoroughness of FAA/JAA collaboration and the "earliness" at which it is likely to commence. The FAA does not simply submit ripe and full-blown FAR proposals to the JAA for comment. On the contrary, any significant airworthiness initiative entertained by either side will now probably emerge from a joint technical study group comprising both FAA and JAA officials, and likely industry from both sides. Exchanges of view and the search for common solutions now appear to characterize the process from its earliest stages. Recent examples of joint projects include the design of a common streamlined ETOPS approval process, the evaluation of passenger protective breathing equipment, the development of contingency ratings for engines on fixed-wing aircraft and the protection of aircraft from high energy radiated electromagnetic fields. At San Francisco, the FAA felt constrained to share with the JAA the fact that it was entertaining the idea of oral as opposed to written export airworthiness applications, even though the idea was still in the most inchoate of forms. The FAA did not want to proceed with the idea without JAA knowledge of that fact.

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[127] Conclusions and Actions of Closed Session, 6th FAA-JAA Meeting, Bordeaux, France (June 1989), p. 6.

In any event, and irrespective of the extent of prior collaboration, all FAA notices of proposed rulemaking are routinely sent to the JAA for comment, and they routinely receive JAA comment to the extent it has not previously been communicated or has not had its desired effect. The JAA is familiar with the procedural models of American rulemaking and cognizant of the fact that the formal publication of proposed rules and the invitation to public comment from interested parties are integral components of FAA rulemaking. For example, an FAA notice of proposed rulemaking on one-engine inoperative ratings for rotorcraft engines has just received JAA comments which are currently under FAA review as part of the usual post-comment rulemaking process.[128] FAA notices of proposed rulemaking have on occasion been amended to into take account subsequent joint FAA/JAA task force recommendations.[129] From time to time, the desire to explore fully and resolve differences of view between the two sets of authorities has caused the Europeans to request an extension of the usual APA public comment period.[130] In a number of instances, that request has been granted.

In some situations, discrepances between the FARs and JARs have not been eliminated, or eliminated soon enough, and private groups have accordingly introduced petitions for rulemaking to that effect. As recently as July 1990, AIA and AECMA jointly petitioned the FAA and JAA to amend certain regulations on certification flight testing,[131] for the stated purpose of standardizing procedures on that subject and thereby facilitating the mutual recognition of tests.

In order that the JAA remain abreast of the FAA's regulatory agenda on airworthiness, the FAA periodically sends it a version of that agenda and a detailed status report on each pending or prospective item, including proposed rulemakings. Such agenda and status reports will be communicated, at a minimum, once a year in advance of the FAA/JAA annual meeting.[132] The agenda will include projects that are merely under consideration in the various FAA directorates for possible future rulemaking.[133]

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[128] Overview, *supra* note 99, at V-5.

[129] For example, an NPRM on reduced screen height for wet and contaminated runways was revised to incorporate a number of recommendations of the joint industry/airworthiness authorities safety enhancement task force.

[130] See Conclusions and Actions in Open Session, 6th FAA-JAA Meeting, Bordeaux, France (June 1989) (item:TSO).

[131] The affected FAR provisions are 14 CFR secs. 25.143(c), 25.143(f), 25.149 and 25.201. 55 Fed. Reg. 29862 (July 17, 1990).

[132] See, for example, Overview, *supra* note 99.

American industry has shown a basically supportive attitude toward FAA/JAA collaboration. This support has been conditional, however, on the FAA's satisfaction of industry concerns over (1) the extent and timing of industry's involvement in the process and (2) the potential competitive advantage that the process may confer on European manufacturers.

The first of these problems has already been discussed at several points in this study. Although the AIA and other industry groups evidently believe that the FAA has done a better job over time of involving industry in its collaboration with the JAA and making joint FAA/JAA activities reasonably transparent, they nevertheless remain concerned that regulatory compromises might be struck between the authorities without an opportunity for adequate and timely industry influence. They want an adequate technical explanation of all regulatory initiatives at an early stage and an ample opportunity for comment and influence.

The second and more focused concern of American industry is that FAA/JAA collaboration may indirectly confer an unfair competitive advantage on European manufacturing interests. The AIA reports, for example, that because AECMA has a closer working relationship with the JAA than AIA has with the FAA, AECMA enjoys superior access to information about FAA/JAA initiatives and indeed about the FAA's own regulatory intentions. With this risk in mind, the AIA has formally requested that the FAA review and amend its procedures so as to "[k]eep all parties advised of issues at the same time." and "[p]rovide an environment in which all parties can effectively participate in the process of development of common ground between European and American airworthiness requirements, safety requirements and regulations."[134] American industry is thus concerned not only with the question whether its European counterpart will derive unfair advantage from the substantive rules that the FAA and JAA jointly develop, but also with the question whether the collaborative process itself tends to favor those national interests--in the event, the Europeans--that enjoy less of an arm's length relationship with their own national authorities.

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[133] The latest such agenda included, for example, possible changes in required aisle and passageway dimensions and configurations.

[134] Letter of April 9, 1990 from D. Fuqua, President, AIA, to Hon. James S. Busey, FAA Administrator.

## 2. FAA Utilization of Foreign Government Views

Prior sections of this report have shown that JAA opinion influences FAA regulatory policy chiefly through one of two processes. Sometimes the JAA has communicated its reservations about existing Federal Aviation Regulations in the course of considering them for adoption as JARs, in which case an often long and uncertain process of consensus-seeking follows. A good example is the notice of proposed rulemaking of April 1989 that sought to introduce changes to the type certification requirements for normal and transport category rotorcraft in the interest both of standardization and improved aviation safety.[135] The changes were based on proposals that had been submitted to the FAA by a JAA study group,[136] and that proved attractive to the FAA in part because their adoption would in turn ensure the Europeans' adoption of the balance of the FAA's rotorcraft type certificate requirements and "obviate the development of a new and different European standard."[137] In other cases, new or modified airworthiness regulations have emerged from a joint program of identification and solution of air safety problems. As the following section of this report makes clear, in neither circumstance will the virtues of international consultation relieve the FAA of its obligation to conduct rulemaking in conformity with the standard American procedural statutes.

It also can happen, however, that a particular requirement is mostly European in its origins and, in a departure from the usual pattern, the United States may become the beneficiary of a foreign regulatory initiative. An example is JAR 22, on sailplanes and powered sailplanes, which derived chiefly from existing German regulations and later likewise came to be adopted by the Canadian, Australian and Chinese civil aviation authorities. More recently, the FAA took an interest in the JAA's development of a JAR 145 on repair stations once it became clear that the American rule needed updating and that the JAA studies and drafts in preparation of JAR 145 might be useful.

Increasingly, the impetus for parallel rulemaking has come from joint European and American (as well as Canadian) industry efforts. In 1989, aviation manufacturing groups submitted four related petitions for proposed rulemaking and amendments to the FAA and JAA respectively, on flight test requirements. When rulemaking is initiated concurrently in that fashion, the likelihood that the FAA will receive and utilize JAA views on the pending matter is only further enhanced.

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[135] FAA Notice of Proposed Rulemaking no. 89-10, Rotorcraft Regulatory Changes Based on European Joint Airworthiness Requirements Proposals, 54 Fed. Reg. 17936 (April 25, 1989).

[136] Overview, *supra* note 99, at IV-6.

[137] *Id.* (summary)

Whatever the precise sequence in which it comes about, an expression of JAA views will normally be sought on any significant FAA airworthiness initiative. For example, the FAA's agenda for its most recent joint meeting with the European authorities notes that draft copies of a notice of proposed rulemaking on the measurement of stalls in flight were sent to the JAA "with a request for comments and...a joint dialogue on this subject."[138] A reason for the urgency in that case was the FAA's assumption that the proposed change could affect both new Boeing and Airbus aircraft, and its desire that both products be treated equally. Although the influence of JAA views on the FAA is likely to vary from case to case, they invariably carry weight, and the question necessarily arises how much weight they deserve.

Attaching considerable significance to foreign agency views in FAA rulemaking cannot of course in itself be considered objectionable. On the other hand, absent strong congressional indications in its favor, any notion that FAA rules require prior JAA approval would be equally objectionable. One reason why the matter has never been put squarely in terms of a JAA veto is that the collaborative process tends to begin as early as it does, thus lessening the likelihood that strongly divergent views along national lines will form at a later date. For example, a joint industry/authority task force of Americans and Europeans on wet and contaminated runway operations has met periodically to develop a text that might form the basis both of an NPRM and an NPA on the subject. Agreement between the FAA and JAA on such a text has apparently been reached.[139] Similarly, a series of meetings in 1987 and 1988 of joint American and European technical panels (comprising authorities and industry alike) has produced draft criteria for transport category powered lifts. These meetings in fact were preceded by a public notice and invitation for public comment and will eventually be followed by the formal initiation of proposed rulemaking action.[140]

Although international regulatory consensus-seeking is an appropriate and desirable mode of operation, the fact is that it does not invariably produce a commonality of views. In that event, yet further efforts to seek consensus may always be made, but as previously noted there should be no compulsion to succeed at all costs. At present, the FAA, in response to a recommendation from the National Transportation Safety Board and in cooperation with the AIA, is entertaining amendments to its bird ingestion standards (FAR 33). For its part, the JAA does not believe that the current standards require change and in fact has drafted a proposal (JAR-E) that would essentially codify them as they now stand. Negotiations are still ongoing,[141] but perfect agreement between the FAA and JAA does not appear likely. Six meetings between FAA and JAA engine and propeller standards staff have been held over a 2-year period to narrow progressively the differences between American and European standards. Considerable convergence has occurred, due in part to the practice of assigning each participant a top priority item for study, comparison and formulation of a proposed solution wherever important divergences still existed, and also in part to the joint efforts of European and American manufacturers to bridge the regulatory differences. The degree of difficulty in reaching consensus on a given problem turns principally on its technical aspects, and sometimes on special economic or other interests advanced by industry or some other constituency on the American or European side. Beyond that, the moment at which cooperative efforts on a problem are initiated appears to bear some relation to the degree of difficulty encountered. In the bird ingestion case, policy thinking on the American side (prompted by the NTSB), and the formation of preliminary regulatory views, were well advanced by the time coordination with the JAA, AIA and AECMA had begun. Timing in a way thus may have contributed to the impasse.

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[138] Overview, *supra*, note 99, at III-9.

[139] Overview, *supra*, note 99, at III-5.

[140] *Id.* at IV-1.

One procedural obstacle to swifter harmonization mentioned with some emphasis by both the Europeans and by industry (American and European alike) is the strikingly different timeframes in which FAA and JAA rulemaking tend to occur. The American rulemaking process generally requires a good deal more time than its JAA counterpart, with the result that by the time the FAA is ready to lend agreement to a given regulatory proposal the JAA may have substantially reconsidered its thinking or begun entertaining related revisions. This observation only underscores once again the importance of timing in the achievement of international regulatory consensus.

## 3. Legal Problems of Integrating International Negotiation with Domestic Rulemaking

However constructive it may appear to be as agency practice, the FAA's pattern of consultation with the JAA nevertheless raises a variety of procedural problems of a legal character. The fact that the FAA may be seeking or receiving commentary from foreign governmental quarters rather than the more usual private sources should not in principle excuse it from compliance with the ordinarily applicable procedural statutes. This section of the report deals with questions of an agency's legal entitlement to engage in international consultations and the procedural limitations it may have to observe in doing so.

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[141] *Id.* at V-2.

### (a) Agency Authority to Participate in Government-to-Government Consultations

A threshold question worth posing is whether the FAA has statutory authority to engage in the pattern of foreign consultation traced in this report. The FAA has proceeded on the assumption that it has that authority, an assumption amply supported by statutory language. As an arm of the Department of Transportation, the FAA is counseled to "take into consideration any applicable laws and requirements of foreign countries" and "not restrict compliance by any air carrier with any obligation, duty or liability imposed by any foreign country."[142] Given its authority to consider foreign aviation laws and requirements, the FAA would seem to be acting on solid statutory ground when participating in discussions with foreign countries as to their prospective as well as their present aviation norms.

The FAA's authority in this regard should not, however, be thought to depend on the existence of statutory language to that precise effect. If consultation with foreign counterparts promises to yield information of use to an agency in its policymaking functions, then that behavior legitimately forms part of agency practice. In some regulatory spheres, like the FAA's, the case for internationalizing the rulemaking process is a compelling one. Although the agency's authority to engage in international consultations was not as such drawn into question, the Court of Appeals in *Pan American World Airways, Inc. v. C.A.B.*,[143] underscored the need of the then-existing CAB to consult with foreign counterparts and the special deference owed by the courts in the name of comity in the international aviation arena. "There is an obvious need for cooperation, coordination and mutual agreement regarding the regulation of scheduled and charter services among the countries involved in international air transportation."

In fact, international agency-to-agency consultation would seem appropriate even in spheres not as inherently "international" as civil aviation, although in such cases the need for international consultation may not be described as compelling. Information on present or prospective foreign regulatory practice is simply that much more useful knowledge for regulators even of the most purely domestic of subjects. In fact, in a mobile society and global economy, cross-border standardization in virtually any regulatory sphere has potential value, and international consultation is accordingly a procedurally rational course of action.

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[142] 49 App. U.S.C. §1502. The FAA Regulatory Handbook, §1-4d, requires that the FAA act in compliance with the international obligations of the United States.

[143] 517 F. 2d 734, 746 (2d Cir. 1975). The court cited 49 U.S.C. §1502, *supra*.

Apart from the general issue of propriety just evoked, the pattern of FAA/JAA collaboration traced in this report also raises more specific questions of conformity with otherwise applicable American procedural statutes. The balance of this section deals with the rulemaking procedures of the Administrative Procedure Act, as well as with the Government in the Sunshine and Federal Advisory Committee Acts, and more particularly with the procedural mandates embodied in these enactments. It concludes with some rather more general observations of a procedural character.

### (b) The Administrative Procedure Act[144]

The fundamental issue presented by the Administrative Procedure Act (APA) for our purposes is the extent to which its procedural framework for rulemaking accommodates the extended and systematic dialogue that increasingly characterizes the FAA/JAA relationship. The duration and intensity of the FAA's pre-NPRM discussions with the JAA are such that, by the time the FAA proposes a rule for public comment, its vision of that rule will have been shaped in part by, or at least in collaboration with, its European counterparts. Do any administrative law principles stated or implied in the APA place limits on the character of this pre-NPRM activity or require the observance of certain formalities when that activity takes place?

The APA in principle leaves agencies free to gather information and form provisional policy opinions prior to issuance of a notice of proposed rulemaking. Whenever confronted with the question, courts have held that agencies are entitled freely and fully to inform themselves prior to formulating a proposed rule.[145] This is so however "formative" those pre-NPRM inquiries are intended or in fact turn out to be.

On occasion, litigants have argued that pre-NPRM agency conduct may practically speaking be so decisive of the outcome that it must be treated as if part of the rulemaking (i.e., post-NPRM) process and therefore itself preceded by a notice of proposed rulemaking. In *In re FTC Corporate Patterns Report Litigation*,[146] for example, the court faced a challenge to the use by the FTC in its rulemaking of records that it had required private interests to keep and make available to the agency at a pre-NPRM stage. The court held that the imposition and use of record-keeping requirements do not amount to rulemaking "merely on the basis of the possible future use to which the data might be put." *Id* at 302. This was not the strongest case one might imagine for claiming that the rulemaking process for all practical purposes preceded the formal initiation of rulemaking, but neither does it lend any support whatsoever to such a claim.

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[144] The FAA Regulatory Handbook, §1-3a, indicates that the APA constitutes the procedural framework for FAA regulatory activity.

[145] B. Schwartz, *Administrative Law*, ch. 4, sec. 4.8.

[146] 432 F. Supp. 291, 302 (D. D.C. 1977).

Even if the conduct of international negotiations does not legally require the prior initiation of proposed rulemaking, it might be claimed that such activity nevertheless necessitates observance of all APA rulemaking requirements. But that claim too lacks substance, for essentially the same reason that formal initiation of proposed rulemaking is not required. Agencies enjoy a basic freedom in the deliberative processes that precede issuance of proposed rules. A large component of that freedom is the agency's liberty to determine when it has gathered sufficient information to formulate responsibly a proposed regulation and to open it up to public comment. No agency should be expected to embark on regulatory ventures blind. Neither should it be expected to insulate itself from knowledge of the policies and preferences of foreign counterpart agencies, particularly in a domain as marked by regulatory interdependence as is civil aviation. The FAA would be the poorer a regulator as a result. Thus, it would seem counterproductive if not futile to pose a formal barrier to the FAA's dealings with the JAA prior to the initiation of rulemaking proceedings. Provided the FAA, after having learned and possibly been influenced by pre-comment period communications with the JAA or other foreign regulatory authorities, remains genuinely open to different expressions of view, it should be free as a legal matter to have those communications.

The question that next logically arises is whether an agency, once having issued a notice of proposed rulemaking, might then be limited in its international consultative activities. Is the agency required to place in the rulemaking file information about the prior consultations that led to formulation of the proposal? Is it required to record such information about consultations that take place during the comment period?

Courts occasionally have heard the claim that background information upon which an agency relies in its proposed rule must accompany the publication of that rule or otherwise be made available for public comment. At one time in the not too distant past courts took a broadly negative view of that claim. In *Flying Tiger Line, Inc. v. Boyd*,[147] for example, the court relieved the agency of the burden of producing during the rulemaking proceedings positive evidence in support of the proposed rule, and allowed that agencies might take final action largely based on information not publicly presented during the comment period as such, much less at its outset. Certainly the APA does not by its terms require that agencies make public all the background information upon which it may have relied in devising its proposal or, for that matter, ultimately adopting a rule.[148]

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[147] 244 F. Supp. 889, 892 (D. D.C. 1965). According to the court, an agency "may act on the basis of data contained in its own files, on information informally gained by members of the body, on its own expertise, or on its own views or opinions." *Id.*

More recently, courts have held that while an agency may not be required to provide a detailed justification of its rules in proposing them or to disclose all the information that may have had a bearing in their formulation, it must be forthcoming with some such information, particularly where it appears to be critical to the proposal. In *Lloyd Noland Hospital and Clinic v. Heckler*,[149] the plaintiff argued that the Secretary of Health and Human Services had failed in the notice of proposed rulemaking to identify adequately the specific study that formed the basis of the proposed rule and accordingly deprived the public of its right of effective comment. While the court eventually found that any such defect in the notice was cured through timely though subsequent disclosure of the study, it reaffirmed the principle that notices of proposed rulemaking should identify such critical studies where they exist and actually form the proposal's fundamental basis. According to the court, a notice must "disclose the thinking of the agency and the data relied on," at least to the extent necessary for reasonable and meaningful public comment on the proposal. Other courts have adopted a substantially similar position.[150]

Under this general view, joint FAA/JAA technical studies forming the essential foundation of a proposed rule would appear to constitute the sort of essential background material that should be disclosed along or in conjunction with the notice of proposed rulemaking. Such disclosure would substantially promote intelligent public participation in the rulemaking. Similarly, if the FAA were on the basis of JAA consultations to supplement the underlying data in some important way or revise its method of analysis during the course of a rulemaking, it should notify interested persons and allow public comment.

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[148] B.F. Goodrich Co. v. Department of Transportation, 541 F.2d 1178, 1184 (6th Cir. 1976). See generally B. Schwartz, *Administrative Law*, ch. 4, sec. 4.8.

[149] 762 F.2d 1561, 1565 (11th Cir. 1985).

[150] See, for example, City of Stoughton v. EPA, 858 F.2d 747 (D.C. Cir. 1988); United States v. Nova Scotia Food Prods. Corp., 568 F.2d 240, 251 (2d Cir. 1977); Ethyl Corp. v. EPA, 541 F.2d 1, 48-49 CD.C. Cir.), *cert denied*, 426 U.S. 941 (1976); Portland Cement Ass'n v. Ruckelshaus, 486 F.2d 375, 393-94 (D.C. Cir. 1973), *cert. denied*, 417 U.S. 921 (1974). In the latter case, the District of Columbia Circuit found the public unavailability, on a timely basis, of the test procedures and results of the EPA in adopting new-source performance standards for Portland cement plants under the Clean Air Act constituted "a critical defect in the decision-making process." 486 F.2d. at 392. It further held: "It is not consonant with the purpose of a rule-making proceeding to promulgate rules on data that, [in] critical degree, is known only to the agency.

The FAA would risk reversal of its rule upon judicial challenge if it does not.[151]

The question that next arises is whether it suffices simply to disclose the underlying joint technological data, or whether disclosure of the collaboration itself is required? An agency ought not generally be required to identify in detail all its sources and all its motivations. But where the essential technical data for the proposed rule were gathered in joint fashion, with a deliberate view to common American and European standard-setting, that fact may be as essential to an intelligent understanding and appraisal of the rule as the data themselves. Domestic aviation interests and public interest groups may legitimately fear that the pursuit of congruence between American and European standards will compromise the FAA's ability to meet its statutory mandate.[152] They accordingly have a legitimate interest in timely knowledge that a proposed rule springs in substantial part from considerations or processes of this sort. For this reason, it seems highly desirable, where communications from European or other governments have fundamentally or importantly influenced the tenor of a proposed rule, that that fact be acknowledged and that the substance of those foreign government communications be included in the rulemaking file and identified as such.

It is difficult to state with certainty just what material agencies are required under the APA to include in an informal rulemaking file. The Justice Department's Office of Legal Counsel was unable to advise OMB precisely about agency obligations in this regard. But it did suggest that agencies "generally include substantive oral or written communications in the administrative file for public comment and criticism, at least when these communications occur before the close of public comment," on the theory that the statutory requirement of an opportunity by the public to participate in rulemaking implies an opportunity for public comment on all substantive communications from outside the agency.[153] Notwithstanding the uncertainty, it seems reasonable to suppose that, where a proposed rule reflects an agency's determination to reach regulatory accord on a given matter with foreign counterpart agencies, that fact should be made known. At least under circumstances of this kind, both the substance and the fact of an agency's international consultations would seem deserving of inclusion in the administrative file.[154] As a practical matter, since an agency cannot always confidently predict when a court will find that foreign consultation played a significant enough role in the agency's thinking to mandate disclosure, it would do well in case of doubt to make such disclosure.

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[151] Administrative Conference of the United States, *Guide to Federal Agency Rulemaking* (Part III: The Informal Rulemaking Process) 3-5 (1983). The report suggests that, subject to F0IA exemptions, agencies should make all information generated during a pre-NPRM inquiry available for comment by interested persons early in the rulemaking. It also advises that written comments received during the comment period be placed promptly in the rulemaking file in order that persons who choose to comment at a later date may make reference to them. *Id.* at 5.

[152] 49 App. U.S.C. §1346.

[153] Contacts Between the OMB and Executive Agencies Under Executive Order No. 12,291, 5 Op. O.L.C. 107, 111-12 (1981). The Office of Legal Counsel interpreted APA Section 553 as possibly guaranteeing judicial review "on the whole record," and concluded that the latter could be said to include the substance of communications received.

FAA policy and practice appear to reflect these precepts. As a general principle, the FAA maintains that "the public interest is best served when regulatory affairs are open to the public to the fullest extent possible."[155] In fact, FAA procedures expressly address the problem of pre-NPRM comments and properly suggest the circumstances in which they should be made public:

> (a) If the substance of the contact [made before the NPRM is issued] forms one of the bases for issuing the NPRM, [the agency should] discuss the substance of the contact in the preamble. For example, if an outside group met with FAA officials to urge certain regulatory changes and the FAA proceeded to an NPRM, the meeting and interest of the outside group should be described in the preamble even if no petition for rulemaking was submitted.
>
> (b) If there is a legitimate reason not to discuss the contact in the preamble, [the agency should] prepare a report for the docket when the NPRM is issued.[156]

The FAA appears to observe these principles in practice. In the rotorcraft rulemaking discussed earlier, the NPRM issued by the FAA made it perfectly clear that the proposals had been influenced by the thinking of the European authorities and designed to enable the Europeans to accept certification standards that in other respects would parallel the existing FAA standards on rotorcraft. The NPRM itself expanded upon the JAA's role in the genesis and evolution of the proposals:

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[154] Agency communications with foreign counterparts might be claimed to fall within a "deliberative process" exception to the APA's disclosure requirements. See United Steelworkers of American v. Marshall, *infra* note 168. However the Office of Legal Counsel has opined that "the deliberative process does not extend to the legal or policy views of persons outside of executive or independent agencies." See note 153 *supra*, and accompanying text. Such persons, the Office concluded, "are not within the overall decision process of the rulemaking agency." "Their views not being protected by a deliberative process exception, the rulemaking agency would be well advised to place these views in the administrative file and the record for judicial review if the views might affect the agency's decision." *Id.*

[155] FAA Regulatory Handbook, §1-6a.

[156] *Id.* §11-4(b)(1).

> Rotorcraft Regulatory Changes Based on European Joint Airworthiness Requirements Proposals
>
> **SUMMARY:** This notice proposes changes to the type certification requirements for both normal and transport category rotorcraft. The changes would revise airworthiness standards for systems, propulsion, and airframes, and would introduce safety improvements, clarify existing regulations, and standardize terminology. The changes are based on some of the proposals that were submitted to the FAA by the European Joint Airworthiness Requirements (JAR) 29 group. These proposals are intended to encourage the European community's acceptance of the Federal Aviation Regulations' rotorcraft type certification requirements and to obviate the development of a new and different European standard. Adoption of these changes will achieve increased commonality of airworthiness standards among the respective countries.[157]

FAA practice provides additional support for the view that significant pre-NPRM contracts with the JAA should ultimately be recorded in a rulemaking file. The agency's procedures contemplate a special rulemaking variant called an Advance Notice of Proposed Rulemaking (ANPRM), which recognizes the existence of a problem requiring rulemaking, but acknowledges the need for additional knowledge or information before a notice of proposed rulemaking can be formulated.[158] An ANPRM invites the public to respond to specific questions or otherwise furnish information helpful to the agency in developing an NPRM or indeed in deciding that rulemaking is not necessary.[159]

The ANPRM is conducted along basically the same procedural lines as the conventional NPRM, with a rulemaking docket of information and comments available to the public. Since pre-NPRM exchanges between the FAA and JAA produce information of the general sort contemplated by an ANPRM, a functional view would suggest that such exchanges should be treated, for publicity and comment purposes, as if conducted in connection with the FAA's ANPRM procedures, including its requirements of transparency.

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[157] Department of Transportation, Federal Aviation Administration, 14 CFR Parts 27 and 29 [Docket No. 25885; Notice No. 89-10], RIN: 2120-AC27, 54 Fed. Reg. 17936 (Apr. 25, 1989).

[158] FAA Regulatory Handbook, §9-2.

[159] *Id.*

Assuming an agency does not at an early stage disclose, at least in general terms, the fact and substance of prior foreign consultations, there is good statutory reason to suppose that in some cases it would have to do so anyway at a later date. Section 553(c) of the APA requires agencies to incorporate in the rules they adopt "a concise general statement of [the rules'] basis and purpose." This requirement is supposed to help ensure that the agency can articulate a rational basis for its rules and eventually to facilitate the task of a reviewing court in examining the agency's reasoning and the rationality and conformity to statutory purpose of its rules.[160]

Determining just how extensive and detailed an agency's reference to joint technical data, foreign consultations or harmonization has to be in order to satisfy Section 553(c) is not a simple matter. Courts have on occasion upheld published regulations containing virtually no statement of basis and purpose.[161] At other times, they have imposed a level of detail and specificity dictated by the exigencies of subsequent judicial review,[162] as well as a requirement that the statement identify and respond to the principal adverse comments received.[163] It is easy to see how a court taking the latter view might regard a statement of basis and purpose as inadequate if it failed to signal the agency's conscious desire to seek a convergence between its standards and those of other countries, its fundamental reliance on data jointly collected with those other countries or its conduct of international consultations where decisive of outcome. Should these factors surface for the first time on judicial review, and be deemed sufficiently decisive of the process or outcome, a court could well consider the statement of basis and purpose deficient and possibly the notice of proposed rulemaking as well.

Ultimately, disclosure of international consultations should not be predicated on Section 553(c) alone. That provision comes into play only when and if a final rule is adopted, and it presumably would require reference to the foreign consultative process or the harmonization objective only if and when the final rule in the end has the one or the other as its basis or purpose.

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[160] Lloyd Noland Hosp. & Clinic v. Heckler, 762 F.2d 1561, 1566 (11th Cir. 1985); Automotive Parts & Accessories Ass'n v. Boyd, 407 F.2d 330, 338 (D.C. Cir. 1968); Chemical Leaman Tank Lines, Inc. v. United States, 368 F. Supp. 925, 941 (D. Del. 1973). See generally P. Strauss, *An Introduction to Administrative Justice in the United States* 176 (1989).

[161] Alabama Ass'n of Insur. Agents v. Governors of the Federal Reserve System, 533 F.2d 224, 236 (5th Cir. 1976).

[162] Amoco Oil Co. v. EPA, 501 F.2d 722, 739 (D.C. Cir. 1974). The Section 553(c) statement under this view "must be sufficiently detailed and informative to allow a searching judicial scrutiny of how and why the regulations were actually adopted." 501 F.2d at 739. See also Kennecott Copper Corp. v. EPA, 462 F.2d 846 (D.C. Cir. 1972).

[163] Western Coal Traffic League v. United States, 677 F.2d 915, 927 (D.C. Cir.), *cert. denied*, 459 U.S. 1086 (1982).

Postponing notice until that event would be manifestly inadequate from the point of view of promoting public participation in the rulemaking process itself. Outside groups have a manifestly greater opportunity to contribute to the shaping of agency policy, or attempt to do so, if they have some sense of how far an agency's preliminary views have been shaped by foreign government-supplied information, foreign government consultations or the conscious pursuit of internationally common criteria. Accordingly, I would recommend viewing Section 553(c) as merely a supporting reason for a requirement of disclosure of essential foreign consultations in appropriate cases, and not as the requirement's raison d'être.

Thus far, the discussion has been cast in terms of an agency's obligation to place in the rulemaking file information about prior international consultations that shaped the proposed rule. Most of the considerations I have raised in that context apply equally to consultations taking place during the comment period itself. It is difficult to imagine that discussions that would have to be mentioned as essential background if they occurred on a pre-NPRM basis should not receive mention in the rulemaking file if they occur during the comment period. FAA procedures suggest that they should.[164]

The alleged necessity of recording comment period consultations in informal rulemaking has occasionally arisen in terms of an agency's so-called *ex parte* contacts. The APA specifically bars contacts between agency decisionmakers and interested outside parties during formal adjudications and formal rulemaking proceedings, but no such statutory bar applies to rulemaking of an informal variety.[165] Although the D.C. Circuit inferred a bar on *ex parte* contacts in informal rulemaking,[166] subsequent decisions have confined any such restriction to the unusual situation in which discrete private interests find themselves in competition for a specific valuable privilege.[167] Thus, *ex parte* contacts are ordinarily permitted in rulemaking, particularly if they can be viewed as part of the agency's informational and deliberative processes.[168] Neither the standard-setting nor the design type certification activities conducted by the FAA in the airworthiness setting would even remotely approach the rare species of rulemaking that implies a bar on *ex parte* contacts. Interestingly, the remedy for an impermissible *ex parte* contact, should one occur, would ordinarily be its recording in the rulemaking file so that the occurrence becomes a matter of public record and its substance the subject of public comment. Were an agency, as a matter of course, to include a record of its consultations with foreign agencies in the file pertaining to that rulemaking, it would in effect satisfy the conditions of cure for impermissible *ex parte* contacts.[169]

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[164] The FAA requires that for every rulemaking action a public rules docket be maintained, containing summaries of all public contacts (including informal meetings and telephone calls) had during the comment period, and be made available for public examination. FAA Regulatory Handbook, §1-6e. See also §11-3(b)(rulemaking docket should contain documents filed in connection with an FAA rulemaking proposal, including comments, reply comments and correspondence).

[165] B. Schwartz, *Administrative Law*, ch. 4, sec. 4.8. The bill that eventually became the APA originally contained a similar prohibition against ex parte contacts in informal rulemaking. See Justice Department, Office of Legal Counsel, Contacts between the OMB and Executive Agencies, 5 Op. O.L.C. 107, 109-10 (1985).

[166] Home Box Office, Inc. v. FCC, 567 F.2d 9 (D.C. Cir.), *cert. denied*, 434 U.S. 829 (1977).

[167] Action for Children's Television v. FCC, 564 F.2d 458, 477 (D.C. Cir. 1977)

Courts have on occasion been tempted to hold that even if an agency's recordkeeping of post-NPRM communications with outside parties is not mandated by the APA or other procedural statutes, it may be mandated as a matter of procedural fairness and in the interest of effective judicial review.[170] The Supreme court's *Vermont Yankee* opinion[171] effectively sought to put an end to the judicial imposition on agencies of procedures not as such required by general procedural enactments or by the specific enactments under which a given agency operates. That opinion has left open the prospect that courts still might justify the imposition of additional procedures where and to the extent effective judicial review so requires.

The fact remains that agencies would be well advised to disclose their consultations with foreign authorities even when no judicially enforceable principle requires them to do so, provided those consultations are apt to play a significant role in the shaping of agency policy. Among those reasons certainly figures the concern for procedural fairness that in pre-*Vermont Yankee* days might have led a court to impose such a requirement as a matter of law. Effective participation by private groups in public rulemaking proceedings would seem unquestionably to be enhanced when those groups know not only the joint technical data that underlie a proposed rule but also the commitment to international regulatory consensus that may have caused the agency to favor one particular set of standards over another.

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[168] Sierra Club v. Costle, 657 F.2d 298, 400 (D.C. Cir. 1981); United Steelworkers of America v. Marshall, 647 F.2d 1189 (D.C. Cir. 1980), *cert. denied*, 453 U.S. 913 (1981). In this case, the court sought particularly to shield from any ban on *ex parte* contacts communications between agencies, as distinct from those with outside private interests. The JAA bears much functional similarity, in its relations with the FAA, to other federal agencies.

[169] FAA procedures in fact require agency officials to prepare promptly a report of all *ex parte* contacts made during the rulemaking comment period and to include it in the rulemaking docket. FAA Regulatory Handbook §11-4(b)(2).

[170] See, for example, Moss v. CAB, 430 F.2d 891, 893 (D.C. Cir. 1970).

[171] Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, 435 U.S. 519 (1978).

A word should be said about the propriety of consultation with the JAA after closure of the public comment period. Based on my observations, the FAA and JAA alike appear to conduct themselves on the belief that JAA influence in principle should be exerted, if at all, during and not after the comment period. JAA requests for an extension of the comment period, and FAA actions upon those requests, suggest that post-comment period influence should not occur. FAA policy toward *ex parte* contacts after the closing date for comments offers a useful if not a perfect analogy. According to that policy, post-comment period comments are to be discouraged,[172] on the ground that other interested parties would not have reason to expect such comments or to attempt to reply to them. Should they nonetheless occur, a report should promptly be filed in the rulemaking docket.[173]

Whether or not effective judicial review requires an agency to make appropriate references in a rulemaking file to its collaboration with foreign authorities, or the agency chooses to make disclosure voluntarily, the fact of judicial review is likely to bring such collaboration to the surface. An agency may well be called upon by a court to explain why it ultimately overrode expressions of fact or opinion made by private interests during the comment period, and that alone may require reference to the joint technical data arrived at in collaboration with foreign authorities or to the agency's desire to act in standard-setting concert with counterpart agencies abroad. Certainly if there is reason to believe that a final rule would have been different but for the agency's preference for harmonized standards, the factual and policy bases of harmonization may have to appear in the record. A court might conceivably allow an agency to explain and support its rule through judicial testimony or affidavits that effectively supplement the rulemaking record,[174] but more often will remand the rule to the agency for further consideration.[175] In either event, the agency would have found itself in a stronger position upon review, both substantively and procedurally, if it could have pointed to substantial evidence in the rulemaking record of the relevant joint technical data and international considerations.

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[172] FAA Regulatory Handbook, §11-4(b)(3), stating that such comments should be minimized.

[173] *Id.*

[174] National Nutritional Foods Ass'n v. Weinberger, 512 F.2d 688, 701 (2d Cir. 1975).

[175] *Id.* See also Camp v. Pitts, 411 U.S. 138, 143 (1973); Burlington Truck Lines v. United States, 371 U.S. 156, 168-70 (1962).

### (c) The APA Foreign Affairs Function Exemption

The discussion thus far has presupposed application of the Administrative Procedure Act to the FAA's international rulemaking activities. In fact, the question might well be raised whether those activities fall within the APA's exception for "a military or foreign affairs function of United States"[176] and therefore escape APA strictures in any event. Since I conclude that recording of both pre- and post-NPRM consultations, where substantially decisive of outcome, is in any event procedurally advisable, this question could well be bypassed. But it seems of sufficient interest to warrant some discussion.

A first view of the exemption, supported by legislative history, would consider a rulemaking exempt from APA procedures whenever the arena so affects relations with other governments that their observance "would provoke definitely undesirable international consequences."[177] In a leading case, the decision of an international trade body[178] to impose stricter textile import quotas pending consultations was thought to create an incentive for sudden and artificial short-run increases in imports that might only exacerbate the conditions requiring agency action in the first place. The court found these to be the sort of "undesirable international consequences" the APA exemption sought to avert, especially as the timing of the agency's action "may be linked intimately with the Government's overall political agenda concerning relations with another country."[179] Against the background of these and still more pointed examples of regulatory action with genuine foreign affairs implications--such as INS regulatory changes in response to the Iranian hostage crisis,[180] rulemaking about a foreign aid program[181] or strategic foreign policy formulation[182]--the FAA/JAA consultations on airworthiness standards would seem poor candidates for exemption from APA rulemaking procedures on this rationale.

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[176] 5 U.S.C. §553 (a)(1). For an argument in favor of the exemption's repeal, see Bonfield, *Military and Foreign Affairs Functions Rulemaking under the APA*, 71 MICH L. REV. 221 (1972).

[177] American Ass'n of Exporters and Importers v. United States, 751 F.2d 1239, 1249 (Fed. Cir. 1985), citing H. Rep. No. 1980, 69th Cong., 2d Sess. 23 (1946); S. Rep. No. 752, 69th Cong., 1st Sess. 13 (1945). The example cited in legislative history and pertinent to this case is the issuance of a notice of proposed rulemaking during negotiation of bilateral agreements on import quotas, resulting in immediate dumping of foreign inventories onto the American market. For criticism of the exemption's application in this domain, see Araiza, *Notice and Comment Rights for Administrative Decisions Affecting International Trade*, 99 YALE L.J. 669 (1989).

[178] The body in question was the Committee for the Implementation of Textile Agreements (CITA), acting statutorily pursuant to the Agricultural Act of 1956, §204, 7 U.S.C. §1854.

[179] 751 F.2d at 1249. The court emphasized that CITA's authority stemmed in part from the President's foreign affairs power and that the APA's procedural constraints would inappropriately hamper the exercise of that power. *Id.*

[180] Malek-Marzban v. INS, 653 F.2d 113, 116 (4th Cir. 1981); Yassini v. Crosland, 618 F.2d 1356, 1361 (9th Cir. 1980).

[181] See Bonfield, *supra* note 176, at 261.

At least one court has adopted a much broader, and indeed quite expansive, view of the exemption. In its view, the exemption applies to all proposed regulations that "clearly and directly" involve a foreign affairs function.[183] According to the court, whether the exemption applies depends on the function of the regulations themselves, rather than either the adverse international consequences of imposing APA procedures upon them or the source of the agency authority invoked.[184] The court concluded that regulatory action by which the President defines, modifies or possibly violates an international agreement, or directs his subordinates to do so, of necessity "clearly and directly" implicates foreign affairs.[185] Under this interpretation, an agency's consultation with foreign government counterparts, even on otherwise domestic regulatory policy, might fall outside the APA as a foreign affairs function purely on account of the fact that foreign governments have been brought into the picture. The court was careful to point out, however, that the exception cannot be applied to functions "merely because they have impact beyond the borders of the United States."[186]

In some instances, the international involvement will be direct and central to the regulatory purpose. Take, for example, the case of *WBEN, Inc. v. United States*,[187] involving the FCC's consultation with its Canadian counterparts with a view to a new bilateral agreement on the allocation of pre-dawn broadcasting rights. In exempting the FCC from having to provide advance notice of the consultations or an opportunity for comment, the court emphasized the fact that the consultations in question contemplated a formal bilateral agreement on the subject with Canada and therefore had a distinctly direct and central international dimension.

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[182] *Id.*

[183] Mast Industries, Inc. v. Regan, 596 F. Supp. 1567, 1581-82 (C.I.T. 1984). The court clearly rejected any limitation of the exemption to purely "diplomatic" activities, relying on legislative history also cited by Bonfield, *supra* note 176, at 259. See also Consumers Union v. CITA, Civ. Act. No. 74-968 (D.D.C. 1975), *rev'd on other grounds*, 561 F.2d. 872 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 933 (1978), exempting executive action in connection with the negotiation of import restriction agreements with other countries.

[184] *Id.* at 1581.

[185] *Id.* at 1582.

[186] *Id.* at 1581. Legislative history likewise suggests that rulemaking should not be exempt under Section 553(a) unless it "directly" or "clearly and directly" relates to the excluded subject matter. See Bonfield, *supra* note 176, at 236 n. 46, 237, citing legislative history. Bonfield concludes "that rule-making only indirectly or tangentially related to the exempted functions is not to be treated as within the exemptions, and that close cases should be treated as outside the exemption." *Id.* at 237.

[187] 396 F.2d 601, 616 (2d Cir.), *cert. denied*, U.S. (1968).

The FAA's collaboration in standard-setting with the JAA differs discernibly from the FCC activity at issue in the *WBEN* case. FAA/JAA consultations do not yield legally effective international instruments, such as bilateral agreements on wavelength allocation, import restrictions,[188] airworthiness certification or any other subject, and are not intended to. Neither do they take place pursuant to a formally binding international agreement of any kind.[189] On the other hand, this report has attempted to show that civil aviation lends itself especially well to international cooperation and that such cooperation is distinctly advantageous. Under those circumstances, only if compliance with the APA could be shown to burden severely the consultation process would an exemption be justified.

In determining whether compliance with the APA would bring a sufficiently undesirable measure of exposure to the FAA's international consultations to justify the exemption, we should not suppose that an exemption would shelter the FAA's entire rulemaking process. Presumably, in a case like the FAA's, only those steps of the rulemaking process that themselves involve international discussions would be exempt. Thus, an FAA airworthiness standard or type certification would otherwise be adopted according to usual APA rulemaking procedures. It could not sensibly be otherwise. If an agency's rulemaking, start to finish, were to fall outside the APA whenever it chose to incorporate international consultations in the process, the scope of application of the APA would be drastically curtailed. Agencies may almost always find value in discussing prospective regulatory initiatives with foreign counterpart agencies, however "inherently" domestic the activity under regulation appears to be. Although it would seem generally desirable for American agencies to make pertinent international discussions a component of their regulatory process, it would not seem desirable for that practice in effect to clothe their rulemakings with immunity from the APA.[190]

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[188] See Consumers Union v. CITA, *supra* note 183.

[189] Most of the international trade cases raising the foreign affairs exemption entail proposed regulatory change affecting trade subject to bilateral trade agreements. See, e.g., Mast Industries, Inc. v. Regan, *supra*.

[190] Bonfield appears to favor the same view:

> Since rulemaking is exempted from section 553 only "to the extent" that it "clearly and directly" involves such a function...this exemption may apply only to agency rule-making under authority granted it specially *for foreign affairs purposes*. If that is the case, an agency would not be entitled to an exemption...for rulemaking undertaken pursuant to some general nonforeign affairs authority, even though it in fact acted with such foreign affairs considerations in mind.

Bonfield, *supra* note 176, at 260-61 (emphasis in original). The Administrative Conference of the United States has recommended that Congress eliminate the APA's categorical foreign

Even in its necessarily reduced form, the foreign affairs exemption should not, in my judgment, be applied to FAA airworthiness activities of the sort described in this report. As noted, APA requirements for informal rulemaking will otherwise be applicable to the rulemakings in which the FAA engages and their burdensomeness will not be substantially heightened by the inclusion of JAA contacts within their ambit. More important, the requirements associated with notice and comment rulemaking, even when supplemented by appropriate references in the record to the FAA's international discussions, would not seem significantly to hobble the process of consultation or to embarrass its other participants.[191] As far as I know, the FAA does not claim that the foreign affairs function exemption shields its airworthiness rulemakings--either in their entirety or with respect to JAA communications alone--from application of the APA, and such a claim would not seem warranted. This conclusion seems all the more compelling in light of the role that JAA contacts now play in the process. Consultations with the JAA do not occur only randomly or sporadically; they tend increasingly and regularly to influence the substance of FAA regulations and are intended to.

### (d) The Government in the Sunshine Act

The openness provisions of the Government in the Sunshine Act[192] do not appear to have application to the FAA activities described in this report. This statute, which requires agencies to give advance notice of their meetings in the Federal Register and to open them to public observation (or in some cases simply to record proceedings and make the records publicly available), is limited to agencies "headed by a collegial body composed of two or more individual members, a majority of whom are appointed to such position by the President with the advice and consent of the Senate, and any subdivision thereof." Thus, even without reference to its exceptions, the Sunshine Act has no bearing on the FAA, a single-headed body that is itself a component of a single-headed cabinet agency, the Department of Transportation. Although the 1976 statute declares it to be policy that the public have the "fullest practicable

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affairs function exemption and clarify that agencies may by rule prescribe more limited categories of rulemaking exempt from public procedures as cases in which such procedures would be "impracticable, unnecessary, or contrary to the public interest" under section 553(b)(B). Recommendation 73-5, "Elimination of the Military or Foreign Affairs Function Exemption from APA Rulemaking Requirements," 1 CFR. ch. III §305.73-5 (1974).

[191] Sections 553(b)(B) and d(3) independently exclude from APA procedures even rulemaking non-exempt under Section 553(a) where those procedures would be "impracticable, unnecessary, or contrary to the public interest."

[192] 5 U.S.C. §552b.

information regarding the decisionmaking processes of the Federal Government,"[193] the statutory coverage is accordingly severely limited.

Even if the Sunshine Act contemplated activity by single-headed agencies, it is unclear whether it would cover the concerted rulemaking activities examined in this report. Such activities were present in the case of *Federal Communications Commission v. ITT World Communications, Inc.*,[194] a case involving a collegial agency. There, three of the FCC's seven commissioners participated in so-called "consultative process" sessions with European and Canadian counterparts for purposes of the joint planning of telecommunications facilities. They constituted a quorum of the FCC's Telecommunications Committee and were authorized to act on behalf of the FCC. Although for a 5-year period from their inception such meetings were open to all interested parties, in 1979 private parties were excluded. The Supreme Court nevertheless held the Sunshine Act inapplicable.

According to the Court, the crucial issue was whether the FCC Telecommunications Committee was at the time engaged (to quote the Sunshine Act) "[in] deliberations [that] determine or result in the joint conduct or disposition of official agency business." The Court of Appeals for the District of Columbia Circuit had found that the FCC was so engaged:

> The [consultative process] discussions are not "chance meetings," "social gatherings," or "informal discussions" among members, but prearranged conferences held to effectuate public business of the greatest import....They are...an integral part of the Commission's policymaking processes, and as such they constitute the "conduct...of official agency business."[195]

The Supreme Court reversed, essentially on the ground that the Committee at the sessions in question only sought to reach informal policy understandings and did not take final action or indeed any action at all falling within the sphere of its delegated power, which in that case was limited to ruling upon applications for common carrier certification.[196] The Court's opinion cites legislative history to the effect that "informal background discussions [that] clarify issues and expose varying views" should not necessarily have to be conducted in public, lest agency operations unnecessarily be impaired.[197] According to the Court, the Commissioners were engaged in preliminary discussion that did not "determine or result in...official agency business."[198] The Court also observed that when engaged in international consultative processes, the FCC neither convenes nor controls the conduct of the proceedings, and that the session may not even be considered an agency meeting within the meaning of the Sunshine Act.[199] Under the Supreme Court's analysis, FAA/JAA consultations, which likewise do not eventuate in final action, would not be subject to Sunshine Act constraints, even if the FAA were an agency within the meaning of that statute.

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[193] 66 Stat. 1241 (1976).

[194] 466 U.S. 463 (1984).

[195] ITT World Communications, Inc., 699 F.2d 1219, 1244 (D.C. Cir. 1983). The court also rejected the Commission's policy-based arguments that application of the Sunshine Act to international consultations would have "adverse political consequences," and concluded that it bore the burden of demonstrating the need for such an exemption. "Congress [did not] permit the closure of agency meetings simply because foreign representatives are present." *Id.*

[196] 466 U.S. at 473.

### (e) The Federal Advisory Committee Act

The Federal Advisory Committee Act of 1972 (FACA),[200] which provides for the establishment of federal advisory committees, requires that all advisory committee meetings in principle be open to the public, that notice of each meeting be published in advance in the Federal Register and that interested persons be permitted, subject to reasonable regulation, to attend, appear before and file statements in connection with those meetings. In addition, "the records, reports, transcripts, minutes, appendixes, working papers, drafts, studies, agenda, or other documents which were made available" to the advisory committee must be made available for public inspection and copying, subject to the exemptions of the Freedom of Information Act, as must be the minutes of the advisory committee meeting itself. Other requirements of the Act are dealt with below. However, FACA does not apply to any advisory committee declared by the President or relevant agency head to be concerned with matters exempt from the requirements of the Government in the Sunshine Act.[201]

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[197] *Id.* at 469, citing Sen. Rep. No. 94-354 (1975), at 19.

[198] *Id.* at 470, n.7. The Administrative Conference of the United States has urged that the Sunshine Act be amended, in the interest of a freer and fuller deliberative process, to provide that "agency members be permitted some opportunity to discuss the broad outlines of agency policies and priorities...in closed meetings, when the discussions are preliminary in nature or pertain to matters, such as budget or legislative proposals, which are to be considered in a public forum prior to final action." Recommendation 84-3, Improvements in the Administration of the Government in the Sunshine Act, 1 CFR ch. III §305.84-3 (1984).

[199] *Id.* at 473 ("The Act prescribes procedures for the agency to follow when it holds meetings and particularly when it chooses to close a meeting. These provisions presuppose that the Act applies only to meetings that the agency has the power to conduct according to those procedures. And application of the Act to meetings not under agency control would restrict the types of meetings that agency members could attend").

[200] Pub. L. No .92-463, 5 U.S.C. App. I.

The FAA has only recently proposed the creation of an Aviation Rulemaking Advisoty Committee.[202] This action, which had been recommended by the Secretary of Transportation's Task Force on FAA Reform, is described as "a means of improving communications with the public and allowing the public a better opportunity to participate in agency rulemaking."[203] According to its charter, the Committee's 50 members should reflect a fair balance of views representative of the aviation community "including air carriers, manufacturers, labor groups, environmental groups, universities, corporations, associations, consumers, and government agencies other than the FAA."[204] Conversations with FAA officials suggest that the agency conceived the Committee as an instrument for tapping the resources of a wide range of interested outside persons. There is also evidence, however, that the agency views a formal advisory committee as a means of ensuring that these interests are heard and felt to be heard, particularly in a regulatory setting in which outcomes appear increasingly to be the product of joint FAA/JAA discussions.

The fact that the agency is about to establish a formal advisory committee, and that FAA/JAA collaboration appeared to strengthen the case for such a committee, does not entirely put to rest the question whether FACA still has application to FAA/JAA meetings as such and whether all or certain of its provisions should be observed when the FAA and JAA meet. Even after creation of an Aviation Rulemaking Advisory Committee, FACA may remain relevant to the kind of international consultations exemplified by the FAA/JAA relationship. The statute has been applied in other settings to meetings that an agency deliberately holds with outside groups in advance of the issuance of a notice of proposed rulemaking.[205] Moreover, the courts have held FACA applicable to groups that have not been formally established as advisory committees pursuant to the Act,[206] and this would allow the statute to embrace agency gatherings with representatives of foreign government regulatory authorities.

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[201] FACA, §10d, 5 U.S.C. App. I, §10d.

[202] FAA Order 1110 Establishing an Aviation Rulemaking Advisory Committee (March 14, 1990).

[203] *Id.* Remarks accompanying the Order, and constituting the Committee's charter, state that the Committee "will afford the FAA with the opportunity, which it now lacks, of obtaining direct, firsthand information and insight from the substantially affected interests with respect to proposed rules and existing rules that should be revised or eliminated; this advice will result in the development of better rules in less overall time while requiring fewer FAA resources than under the current practice."

[204] *Id.*

[205] See, e.g., Food Chemical News, Inc. v. Davis, 378 F. Supp. 1048, 1050 (D.D.C. 1974).

An "advisory committee," under the Act, signifies "any committee, board, commission, council, conference, panel, task force, or similar group,"[207] whether formally established by statute or either established or simply utilized by the agency itself for purposes of rendering advice or recommendations. In the case of the FAA, the consultations do not involve a group that can be said to have been created by statute[208] or even by deliberate action of the agency,[209] but at most a group that is utilized by the agency.

Whether an agency utilizes a body as an advisory committee within the meaning of the Act depends essentially on functional criteria. Thus, even an advisory body that predates an agency,[210] or has an existence entirely independent of the agency,[211] may be considered an advisory committee to the agency if utilized as such. GSA regulations state that a body is "utilized" as an advisory committee when it constitutes "a committee or other group composed in whole or in part of other than full-time officers or employees of the Federal Government with an established existence outside the agency seeking its advice, which...[an] agency official adopts, such as through institutional arrangements, as a preferred source from which to obtain advice or recommendations on a specific issue or policy within the scope of his or her responsibilities in the same manner as that individual would obtain advice or recommendations from an established advisory committee."[212] Other GSA regulations suggest that the Act's chief concern is an agency's recurrent use of a particular group as a preferred source of advice or recommendations.[213]

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[206] *Id*. at 1051. The court held that failure of an agency to charter and establish a committee in accordance with FACA "cannot be employed as a subterfuge for avoiding the Act's public access requirements." *Id*.

[207] FACA, §3(2), 5 U.S.C. App. I, §3(2).

[208] For an advisory committee to be established by statute Congress must have more or less directly contemplated the creation of such a committee. Lombardo v. Handler, 397 F. Supp. 792, 796 (D.D.C. 1975).

[209] Only committees "directly established" by an agency would fall in this category. See Lombardo v. Handler, *supra*, at 797, citing legislative history. Conf. Rep. No. 92-1403, 92d Cong., 2d Sess., as reprinted in 1972 U.S. Code Cong. & Admin. News 3509.

[210] Lombardo v. Handler, 397 F. Supp. 792, 798-99 (D.D.C. 1975), citing legislative history. H.R. Rep. No. 92-1017, 92d Cong., 2d Sess., as reprinted in 1972 U.S. Code Cong. & Admin. News 3494.

[211] Center for Auto Safety v. Cox, 580 F.2d 689, 694 (D.C. Cir. 1978). The case confirms that FACA may apply to a preexisting organization. *Id*. at 693-94.

[212] 41 CFR §101-6.1003 (1990).

[213] *Id*., §101-6.1004(j).

The Supreme Court recently determined that the term "utilized" should not necessarily be given its plain meaning when used in the FACA context. Faced with the claim that the ABA's Standing Committee on the Federal Judiciary constitutes an advisory committee when advising the President through the Justice Department on the qualifications of potential federal judicial nominees, the Court in *Public Citizen v. Department of Justice*[214] ruled that a body is not in all cases utilized as an advisory committee simply because the President or an agency seeks its advice:

> A nodding acquaintance with FACA's purposes, as manifested by its legislative history and as recited in §2 of the Act, reveals that it cannot have been Congress' intention, for example, to require the filing of a charter, the presence of a controlling federal official, and detailed minutes any time the President seeks the views of the NAACP before nominating Commissioners to the Equal Employment Opportunity Commission, or asks the leaders of an American Legion Post he is visiting for the organization's opinion on some aspect of military policy.[215]

In order for an organization to constitute an advisory committee it must provide an agency with "advice or recommendations." One court, declining to identify any single factor as conclusive of this question, held that when an agency in the course of developing regulations discloses them in draft to select groups in order to obtain their advice and recommendations, it utilizes these groups as advisory committees.[216] On the other hand, the court made it plain that not all contacts between an agency and an outside group necessarily constitute utilization of an advisory committee, even if some of them do, and insisted that committees be held subject to FACA only when and to the extent they actually function as advisory committees as described above, that is, render advice or recommendations on proposed regulations.[217] Under this general analysis, the JAA conceivably constitutes an advisory committee whenever it renders "specific" advice on pending draft regulations,[218] but not when it simply exchanges information with the FAA, thus serving an informational purpose that FACA does not cover. GSA regulations implementing FACA confirm Congress' purpose to exclude bodies whose services to an agency are "for the purpose of exchanging facts or information."[219] Case law has also excluded from FACA discussions with private groups about the latter's own initiatives and proposals, even though agency comments and reactions were solicited.[220]

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[214] 109 S. Ct. 2558, 2565 (1989).

[215] Id. at 2565. The Court likewise rejected the notion that the President utilized an advisory committee when he consults with his political party before selecting his Cabinet.

[216] Center for Auto Safety v. Cox, *supra* note 211, at 694, citing Nader v. Baroody, 396 F. Supp. 1231, 1234 (D.D.C. 1975), *vacated as moot*, No. 75-1969 (D.C. Cir. 1977).

[217] Center for Auto Safety v. Cox, *supra* note 211, at 694.

[218] Center for Auto Safety v. Tiemann, 414 F. Supp. 215, 223-24 (D.D.C. 1976).

Although the JAA meets the functional criteria of an advisory committee when it acts in certain of the capacities observed in this report, I am not inclined to consider the JAA an advisory committee within the meaning of the Act.

First, there remains a remarkable degree of doubt, even nearly 2 decades after passage of the Act, whether FACA applies to bodies that are not acknowledged by the agency in establishing or utilizing them to constitute advisory committees. The case law is confused and the commentators divided,[221] and the Act's application to the JAA is correspondingly uncertain. On the one hand, FAA/JAA contacts cannot be described as the ad hoc, casual and random sort--lacking in continuity and follow-up--that have been said to escape FACA;[222] they may well constitute "institutional arrangements which amount to the adoption of the group as a preferred source of advice,"[223] for they are deliberate and systematic, increasingly so, and obviously carried out at the government's instance and with public funds. Compared to the ABA judicial selection committee at issue in the *Public Citizen* case, the JAA is a much better example of the group targeted by FACA, one "organized by or closely tied to the Federal Government, and thus enjoying quasi-public status".[224] On the other hand, it does not seem quite accurate to describe the JAA as a source of "expert, technical and scholarly advice from experienced and representative individuals who are not regularly available as officers and employees of the government."[225] The Supreme Court's *Public Citizen* decision, while not clearly demarcating the line between outside groups "utilized" and "not utilized" by agencies as advisory committees, makes it plain that FACA cannot be understood "to cover every formal and informal consultation between the President or an Executive agency and a group rendering advice".[226] And it strongly suggests that advisory committees established by the agencies as such were the Act's principal target.[227] The JAA does not comfortably meet that description.

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[219] 41 CFR §101-6.1004(1)(1990). Under the GSA interpretation, FACA's chief targets are bodies that serve as an agency's "preferred" source of advice. Administrative Conference of the United States, *Federal Administrative Procedure Sourcebook* 494 (1985).

[220] Consumers Union of United States, Inc. v. Department of HEW, 409 F. Supp. 473 (D.D.C. 1976), *aff'd mem.*, 551 F.2d 466 (D.C. Cir. 1977).

[221] See Cardozo, *The Federal Advisory Committee in Operation*, 33 AD. L. REV. 1, 28 (1981). One court has suggested that, in the case of committees not actually established or organized by agencies, FACA would be satisfied by a policy of open meetings and accurate recordkeeping, and little else would be needed. Center for Auto Safety v. Cox, *supra* note 211, at 695. It is not firmly established, however, that the various requirements of FACA are legally severable.

[222] Nader v. Baroody, 396 F. Supp. 1231 (D.D.C. 1975). See also Consumers Union of United States, Inc. v. Department of HEW, 409 F. Supp. 473 (D.D.C. 1976), *aff'd mem.*, 551 F.2d 466 (D.C. Cir. 1977). In the *Consumers Union* case, *supra*, the court pointed out that, absent the continuity associated with advisory committees, the meetings of the cosmetics, toiletry and fragrance association in question would constitute "valid private meetings similar to numerous agency-industry or agency-consumer gatherings taking place daily at FDA." *Id.* at 474.

The Administrative Conference has taken the view that FACA should not be applied to ad hoc, unstructured and noncontinuing agency contacts with outside groups. Recommendation 80-3, "Interpretation and Implementation of the Federal Advisory Committee Act," para. 2(a).

[223] Recommendation 80-3, *supra* note 222, para. 2(b).

The recent federal court decision in *Center for Auto Safety v. Federal Highway Administration*[228] confirms this reading of the *Public Citizen* opinion and the improbability of the meetings between the FAA and JAA constituting advisory committee meetings within the meaning of FACA. There, the FHWA had made use of a task force of the American Association of State Highway and Transportation Officials (AASHTO) (and indeed an updated version of AASHTO's Green Book on Geometric Design) in developing national standards for highway and street design.[229] Turning back plaintiff's FACA challenge to the agency's reliance on the AASHTO task force, the court emphasized that, under *Public Citizen*, a group is not "utilized" under FACA unless it is formed by the Executive Branch or by quasi-public organizations. It found this not to be the case of AASHTO:

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[224] 109 S.Ct. at 2570. The opinion suggests that only groups actually formed "at the behest of the Executive or by quasi-public organizations" or that "the Federal Government helped bring into being" should be considered as "utilized" by the executive. *Id.* at 2570-71. In other words, the statutory language "established or utilized" by the agencies connotes groups "established by *or for* such agencies." *Id.* (emphasis added).

It was not obvious to the Court that the ABA judicial selection committee fell outside the scope of FACA. The Court found this "a close question," though it was ultimately "fairly confident" of the answer. *Id.* at 2572. The JAA's escape from FACA is probably not a great deal more obvious.

Three justices, concurring in *Public Citizen*, found that the ABA Committee fell squarely within the statutory definition of advisory committees "utilized" by the government, especially as clarified by GSA interpretive regulations. The Committee consisted at least in part of persons other than full-time federal employees. It had an established existence independent of the agency seeking its advice. It represented a preferred source of advice to the government. Its relation to the government had become fairly institutionalized. And its views were used by the government in much the same way as views of established advisory committees. 109 S.Ct. 2573, 2578 (Kennedy, J., concurring). The JAA basically satisfies these same criteria.

[225] Cardozo, *supra* note 221, at 51.

[226] 109 S.Ct. at 2565-66.

[227] "FACA's principal purpose was to enhance the public accountability of advisory committees established by the Executive Branch and to reduce wasteful expenditures on them." *Id.* at 2568.

[228] Civil Action No. 89-1045 (D.D.C., Oct. 12, 1990).

> It is evident, and conceded by both parties, that AASHTO was not established by the FHWA. FHWA does not fund AASHTO, does not set its agenda, or appoint its members. Nor is the AASHTO an offspring of a quasi-public entity subject to FACA. In light of *Public Citizen*, these uncontested facts dictate a finding that AASHTO is not subject to FACA.[230]

To the same effect is *Food Chemical News v. Young*,[231] in which the Court of Appeals for the District of Columbia recently reaffirmed that FACA applies only to groups organized by or closely tied to the federal government, and thus enjoying quasi-public status. It found, in keeping with the Supreme Court opinion in *Public Citizen*, that the term "utilized" was not to be understood in the ordinary or literal sense of the word (as in "made use of"), but rather as denoting a group that, while not organized as such by an agency, is so closely tied to it as to be amenable to strict management by agency officials. The court declined to subject to FACA a panel of experts selected and managed by a private scientific organization pursuant to the organization's contract with the FDA to provide advice on food and cosmetics safety issues.

The *Center for Auto Safety* case, *supra*, also raises squarely the question whether a task force that is not otherwise an advisory committee, within the meaning of FACA, becomes one on account of the fact that agency officials figure among its members. In the case, FHWA employees participated actively in the AASHTO proceedings in question. The court acknowledged that this element "does raise the specter of secret advice channels to the agency and of agency capture by an outside consultant."[232] Nevertheless, it found that the "potential abuses created by intergroup membership" were not alone enough to require a different result. The court relied in part on the agency's observance of public rulemaking procedures. "[P]rocedural safeguards such as public rulemaking proceedings prior to federal adoption of AASHTO findings ensure that AASHTO findings are not simply rubberstamped"[233].

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[229] AASHTO is a nonprofit privately incorporated association of state government transportation agencies.

[230] Civil Action No. 89-1045 (D.D.C., Oct. 12, 1990), p.5.

[231] Civil Action No. 89-5142 (D.C. Cir. Apr. 6, 1990).

[232] Civil Action No. 89-1045 (D.D.C. Oct. 12, 1990), p.5.

More important, FACA's legislative history suggests that Congress chiefly feared abuse by special interests of their representation on advisory committees "to promote their private concerns."[234] As the Supreme Court recently observed, "FACA was enacted to cure specific ills, above all the wasteful expenditure of public funds for worthless committee meetings and biased proposals."[235] This helps explain why FACA only addresses advisory committees at least some of whose members are not full-time federal government employees,[236] and perhaps also why the Act specifically exempts the Advisory Commission on Intergovernmental Relations from its coverage.[237] It may also help explain why the American Association of State Highway and Transportation officials (AASHTO) task force at issue in *Center for Auto Safety v. Federal Highway Administration* was considered so poor a candidate for FACA treatment.[238] Admittedly, foreign government officials cannot properly be considered federal or state government employees for these or any other purposes. Nevertheless, there is virtually no evidence to suggest that the JAA approaches its dealings with the FAA with the promotion of "private concerns" or "special interests" in mind or that the JAA can be said to embody those concerns or interests.[239] The question, as one court put it, is whether outside groups consulted by the government are "self-serving."[240] The JAA gives few signs of that.

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[233] *Id.* at 6.

[234] Food Chemical News, Inc. v. Davis 378 F. Supp. 1048, 1051 (D.D.C. 1974). In *Davis*, the court held FACA inapplicable to two informal meetings held by the Bureau of Alcohol, Tobacco and Firearms with consumer and distilled spirits industry representatives on ingredient labelling of distilled spirits. The Director of the Bureau scheduled those meetings to obtain the groups' comments or suggestions on proposed regulatory amendments and intended to use them.

[235] Public Citizen v. Department of Justice, 109 S.Ct. 2558, 2565 (1989).

[236] See Cardozo, *supra* note 221, at 3. Cardozo writes that a committee containing any number of officers of government is not covered by the Act unless its membership includes outsiders, representatives of the 'private sector.'" *Id.*

[237] See note 256 *infra* and accompanying text.

[238] See notes 228-30 *supra* and accompanying text.

[239] In Center for Auto Safety v. Tiemann, 414 F. Supp. 215 (D.D.C. 1976), the agency sought to defend its noncompliance with FACA on the ground that the outside organization in question did not consist of representatives of private interests, but rather public servants (in the event, state highway and transportation officials). The court emphasized that the organization was not as "public" as appeared, since it represented recipients of grants under the federal-aid highway program, hence special interests within the context of the agency and program in question. "AASHTO *is* made up of public servants. But those state employees also represent the 'regulated' in the federal-aid highway program before the 'regulators,' the federal government." *Id.* at 225 (emphasis in original). The JAA would not seem to be even remotely as specially interested in the outcome of airworthiness regulations as state officials--prospective beneficiaries of federal highway aid--would be in that regulatory program.

Finally, although it arises in the Sunshine Act context, the Supreme Court opinion in *FCC v. ITT World Communications*[241] counsels against considering consultations with foreign government agencies activities to which a statute such as FACA should be applied. The Court there held that the Sunshine Act applies "only to meetings that the agency has the power to conduct according to these procedures"[242] and concluded that the FCC's consultation sessions with foreign counterpart agencies did not constitute such meetings, if only because the FCC could neither convene them nor unilaterally control their conduct. Although FACA, unlike the Sunshine Act, does address meetings of bodies other than agencies--namely advisory committees--its application to consultation sessions with foreign agencies would raise similar concerns about undue inhibition of agency activity. Because FAA/JAA meetings are not wholly within the FAA's capacity to control, FACA's application, to quote the Court, "would restrict the types of meetings that agency members could attend"[243]. If the Court regarded application of the Sunshine Act to the FCC's international consultations as working unduly broad restraints upon agency process,[244] particularly in the international sphere, it is difficult to imagine that it would favor inhibiting such consultations by application to them of the Federal Advisory Committee Act.

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This is not to suggest that so-called representatives of the public interest cannot be considered "special interest groups." In Food Chemical News, Inc. v. Davis, *supra* note 234, FACA was held applicable to agency meetings with industry and consumer groups alike, even though the latter purported to represent the public rather than any particular private interest.

[240] Consumer Union of United States, Inc. v. Department of HEW, 409 F. Supp. 473, 475 (D.D.C. 1976), *aff'd mem.*, 551 F.2d 466 (D.C. Cir. 1977). Cardozo identifies as the target of FACA the regular holding of closed-door meetings between government and big business "turning out report and recommendations that were influencing government action against the interest of consumers, small business and other outsiders." Cardozo *supra* note 221, at 48-49.

The view that FACA contemplates special interest groups in particular probably underlay another Administrative Conference recommendation, Recommendation 78-4, para. 1(e), that urged FACA's amendment to exempt technical committees and standard-setting organizations. 44 Fed. Reg. 1357 (1979). In support of this recommendation, see Hamilton, *The Role of Nongovernmental Standards in the Development of Mandatory Federal Standards Affecting Safety or Health*, 56 TEX. L. REV. 1329, 1477 (1978), arguing that application of most FACA provisions to technical committees would be "unfortunate."

[241] 466 U.S. 463 (1983).

[242] *Id.* at 473.

[243] *Id.*

[244] *Id.* at 473-74.

It is useful, in this last regard, to remember that FACA entails more than the advance notice, openness and recordkeeping of meetings with which it is commonly associated. A finding that a body constitutes an advisory committee under FACA brings in its wake a host of other requirements that fit poorly with the realities of the international working relations that bind the FAA and JAA. FACA was enacted in large part to stem the tide of advisory bodies specially created for the purpose of advising federal agencies, and accordingly contains numerous rules limiting the creation of such bodies. In theory, an agency should not establish advisory committees unless their creation is formally found by the agency head--after consultation with the director of OMB and upon publication of notice in the Federal Register--to be necessary and in the public interest. Once established, committees are subject in their operation and duration to uniform standards and procedures. They are required to have "fairly balanced" memberships "in terms of the points of view represented and the functions performed." The agency must also protect its advisory committees against undue influence by any special interest and provide for their duration, finances, staffing, housing and reports.[245] A committee may not act at all until it files a detailed charter with GSA, with the agency to which it reports, with the pertinent congressional committees and with the Library of Congress.[246] Its existence and activities must be known to the public. Committees automatically expire after 2 years unless renewed or specifically exempted by the agency establishing them.[247]

FACA goes still further in regulating the internal structure and external relations of advisory committees. A federal official is required to chair or attend every committee meeting, and no meeting may be held, and no agenda followed, without the advance approval of a designated officer.[248] That official is authorized to adjourn any meeting when he or she deems its adjournment to be in the public interest. Meetings must be held at reasonable times and in places (of sufficient capacity) reasonably accessible to the public, and minutes of all meetings must be kept.[249] For each committee that reports to it an agency must appoint a Committee Management Officer responsible for monitoring the committee's performance, for maintaining its records and for making the findings needed to justify a decision to close a meeting to the public.[250] A Committee Management Secretariat, lodged in the GSA, has general oversight and recordkeeping responsibility for all established advisory committees, and authority to recommend their continuation, discontinuation or reorganization.[251] Decisions on the latter subject are ultimately made by standing committees of the House and Senate having jurisdiction over the agencies to which advisory committees report.[252]

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[245] FACA, §§5(b), (c), 9(a).

[246] *Id.*, §4(c). The charter must recite a good deal of organizational, operational, and financial detail.

[247] *Id.*, §14. Review would be conducted by Congress and OMB.

[248] *Id.*, §§10(e), (f).

[249] *Id.*, §10(c).

[250] *Id.*, §8.

Extension of these myriad requirements to preexisting private sector groups is obviously problematic. According to one view, they sensibly apply only to advisory committees formally and expressly established as such by Congress, the President or the agencies, and not to independent groups whose services are simply utilized by the agencies. As to the latter, advance notice, openness and recordkeeping of meetings (perhaps along with representativeness of membership) would be the essential points. However, whether such a distinction is consistent with statutory language and purpose remains an open question.[253] Application of FACA would obviously be all the more problematic in connection with bodies--such as the JAA--that have been independently created by one or more foreign governments, that consist in whole or in part of foreign government officials, and that would likely resent and reject efforts to bring them within the reach of FACA, in whole or in part.[254]

There is, in sum, scant evidence that Congress intended or would have wanted FACA to be applied to intergovernmental relationships such as have developed between the FAA and JAA. Congress, it is true, specifically exempted certain committees from coverage by FACA, and organizations composed of foreign government officials was not among them.[255] On the other hand, Congress did create an exemption for the Advisory Commission on Intergovernmental Relations, ostensibly because bodies advising public officials "on problems affecting more than one level of government" present special difficulties and what the Act calls a "unique character."[256] Intergovernmental bodies addressing problems affecting two or more countries or groupings of countries would seem to present at least as special a situation and therefore likewise call for special treatment.

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[251] *Id.*, §7a.

[252] *Id.*, §5a.

[253] Cardozo, *supra* note 221, at 13.

[254] The Administrative Conference similarly recognized that technical standard-setting committees on which agencies rely would refuse to cooperate with the agencies if FACA were fully applied to them. See note 240 *supra* and accompanying text.

[255] Among exempted committees are the Committee on Government Procurement, Committees on the Federal Reserve System and committees established to advise Congress or the courts. FACA, §2.

[256] See Cardozo, *supra* note 221, at 19.

A previous Administrative Conference recommendation on the subject of FACA suggests that a degree of public access may be desirable even if an outside group is not considered to have the status of an advisory committee under the Act.[257] The FAA's relationship with the JAA, and the significance of that relationship, are such that a policy of openness and public availability is highly desirable even though FACA may not mandate it. My impression is that the FAA and JAA--short of holding all their consultations in public with advance notice--do nevertheless seek to make their conclusions and the data underlying them fully open to interested groups and to afford them reasonable opportunity for comment and influence.

### (f) General Procedural Concerns

Even if the FAA/JAA consultation process passes muster under the various federal procedural enactments that plausibly bear upon it, or if all the suggested precautions are observed, lingering procedural doubts about the legitimacy of the system may persist. The very spirit of compromise and mutual consideration that gives the FAA/JAA relationship its visibly special character also raises general questions about the integrity of the rulemaking process that it affects. One way to put the question is to ask whether the Aircraft Certification Service engages in such close collaboration with its European counterparts as to risk compromising its independence of judgment. The question acquires a special reality if we suspect, as perhaps in the helicopter and other episodes, that the rules the FAA actually adopts differ in not insignificant ways from those it most likely would have adopted in the absence of JAA influence, and it accordingly has both procedural and substantive dimensions. Our procedural concern would be that once negotiations with foreign counterpart agencies yield a regulatory compromise, an agency will be hard-pressed to entertain seriously proposals from domestic quarters that would result in departures from the international understandings reached,[258] departures that might in fact be preferable in terms of the agency's statutory mandate. To put the question in more squarely substantive terms, do FAA/JAA consultations--whether pre- or post-NPRM--impermissibly predetermine the outcome of FAA airworthiness rulemakings, and do they lead aviation officials to make excessive compromises in the interest of commonality?[259]

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[257] Recommendation 80-3, *supra* note 222, para 2c: "Agencies should be sensitive to the desirability of making available to the public advice or information obtained from private or ad hoc groups not covered by FACA when the agency is considering action based on such advice or information."

[258] At their San Francisco annual meeting, the authorities agreed in closed session that they would announce to industry in open session that the FAA and JAA had each resolved to go forward with a common proposed rule on "rejected takeoff safety enhancements" ("RTO") upon which the two sets of authorities had previously reached agreement. The authorities correctly perceived that, while industry might feel that the agencies had by that time effectively made up their minds, industry also basically supported the proposal and saw considerable advantage in the existence of common standards.

These fears are not entirely baseless. However, even in situations where courts have acknowledged the distinct possibility that "private" arrangements may have effectively predetermined the regulatory outcome, they have not declared those arrangements illegitimate or forbidden the communications of which they consist. Appropriate recording of the fact and substance of the communications, and their timely exposure to public comment, have been deemed an adequate procedural solution.[260] At all events, it bears remembering that the JAA and like bodies are not perfectly assimilable to private regulated interests whose *ex parte* contacts with agencies even in a rulemaking context have caused alarm among those who have felt themselves left outside. They are themselves "public" bodies. Unless they can realistically be considered little more than conduits for influence by their domestic industries, or their objectivity can otherwise be called into question, their collaboration with American agency counterparts should not be thought to introduce a dangerous or impermissible bias.

Nevertheless, an agency--whether procedurally required to do so or not--should be alert to the possibility that in being influenced by the data or policy positions advanced by counterpart agencies abroad, it may be indirectly coming under the influence of private interests with a stake in the regulatory outcome or of divergent "foreign" public interests, or otherwise be led astray from the purposes that the agency is statutorily called upon to serve. Thus, if international regulatory consensus is a legitimate agency objective, and regular international consultation a legitimate instrument to that end, steps should be taken to avert the reality or the perception that regulated or other affected interests are excluded by the process. A first remedy, alluded to throughout the immediately preceding sections of this report, would be to ensure a reasonable degree of transparency in the FAA/JAA collaboration. This means making the fact and tenor of that collaboration reasonably conspicuous in the notice of proposed rulemaking, in the rulemaking file and in the rule's statement of basis and purpose.

A second and distinct remedy would be to ensure that regulatory accords informally reached between the FAA and JAA are genuinely subject to reexamination and reconsideration by the agency in the course of the comment period. Agencies can legitimately be required to "consider" all expressions of view (and impliedly to enable all expressions of view to be heard).[261] Courts on judicial review may well demand that agencies demonstrate that they have considered and possibly even responded to all such expressions before finally adopting a rule. The genuineness of this attitude, it must readily be acknowledged, cannot ever be adequately policed. Agencies ultimately will have to be trusted to keep open minds, or at least be willing to reopen matters with their foreign government counterparts, even after informal agreement with them appears to have been reached.

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[259] The FAA Administrator has remarked that the objective of FAA/JAA collaboration is "easy" to state. "We want our regulations to mirror each other." Remarks by Admiral James B. Busey, FAA Administrator, *supra* note 95.

[260] See Moss v. CAB, 430 F.2d 891 (D.C. Circ. 1970).

Perhaps the most promising remedy for the real or perceived exclusion of private interests from intergovernmental arrangements would be the deliberate inclusion of those interests in the arrangements themselves. FAA/JAA collaboration in fact has not only been made increasingly transparent to the outside, but has actually enlisted representatives of regulated interests as active participants. The information and views of manufacturers, airlines and, to a lesser extent, other affected interests are considered well before the authorities arrive at joint positions on any given issue. In a more or less systematic fashion, they are included in the study teams and working groups that help prepare those positions. Private interests understandably express less discomfort with the fact that FAA rules tend to mirror FAA/JAA understandings when they believe themselves to have been a part of the process by which the initial understandings were reached.

As the FAA moves toward a model of rulemaking in which private participation takes place at the earlier international consultation stage, as well as at the later and more conventional NPRM and comment stage, then the selection of interests becomes correspondingly important. An agency that enlists or accepts the aid of private interests in its international collaboration should first ensure that those interests are reasonably inclusive. In the airworthiness setting, for example, depending on the issue at hand, airlines, manufacturers, pilots, and repair stations, among others, all may have a contribution to make or an interest to protect.

A second and related concern is the representativeness of the interests that are included. To take only the most prominent examples in the FAA setting, aircraft manufacturers and operators alike are a diverse lot, as gauged by any number of indicators, and their stakes in regulatory issues may diverge accordingly. Although I have concluded that FACA does not apply to FAA/JAA consultations as such--largely because of their public and intergovernmental character--its concern that private advisory groups display balance and representativeness becomes relevant as inclusion of private interests in those consultations progresses.

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[261] B. Schwarts, *Administrative Law*, ch. 4, sec. 4.10.

More problematic is the question whether and, if so, how an agency should seek to enlist the participation in its intergovernmental efforts of interested groups other than the interests actually regulated, for example, various consumer, worker or environmental interests. Ideally, those interests will be fully considered in the pre- as in the post-NPRM period. However, in order to be effective, FAA/JAA collaboration must be workable, and there may simply be no workable way to involve all such groups in an organized fashion in the international collaborative process. If they cannot participate systematically and integrally in the preparatory intergovernmental arrangements, then they will have to intervene at one or more junctures at the national level, for example by shaping the national positions at their very formative stages or by participating conventionally in the national notice-and-comment procedures that separately follow the adoption of a common intergovernmental position.

It is desirable, as a general matter and within the limits of feasibility, that all affected interests--regulated and nonregulated alike--be heard in some fashion, however indirect, before joint national authorities arrive at a common proposed position. To the extent they are heard, that position has an improved chance of adoption by the competent national authorities without controversy, change or challenge at the conclusion of their respective domestic rulemaking procedures, and the goal of international regulatory harmonization will have a correspondingly greater chance of being met. Nevertheless, the feasibility of an all-inclusive international deliberative process will have its limits and cannot help but vary with the agencies involved and the subject matter at issue. The FAA's experience of including private and public interest representatives in both the meetings and study groups under the FAA/JAA umbrella, though perhaps not yielding a fully balanced and effective representation, does demonstrate, however, that it would be wrong to assume that such representatives cannot be actual participants in an agency's international regulatory cooperation efforts.

These general procedural observations would be incomplete if they did not at least raise the squarely substantive problem of regulatory compromise that attends an agency's decision to collaborate systematically with overseas counterparts. Even while following all the procedural precautions suggested in this report, an agency must face the question of how many and how great are the concessions it should make to its counterpart agencies in the interest of commonality and cooperation. The question defies a clear or all-purpose answer. However, an agency's search for agreement certainly should not be one that holds it hostage to the views of foreign governments. Nor should it be one that regularly causes the agency to adopt standards that fall decidedly above or below those the agency independently deems appropriate or that run afoul of the mandated policy analyses.[262] As in any venture presupposing a degree of mutual give-and-take and a readiness to compromise, there must be limits, as for example when one or the other side finds that public welfare will be severely endangered by proposed regulatory action or that such action will impose unacceptable burdens of one sort or another. Situations will arise in which it may be preferable to tolerate regulatory discrepancies than to demand a common accord that leaves one or both sides with the conviction that a very serious regulatory mistake has been made. Finally, it would be unwise and undesirable in any event for an agency to commit itself in advance to compromise on any issue at all costs.

The concern understandably arises that when authorities of different nations cooperate in search of consensus over regulatory standards, the final product will represent the least common denominator of the interests represented and a diminution of the level of protection existing in the more protection-minded countries. Though entirely plausible, this concern does not appear to have a basis in fact in the FAA/JAA experience. This is due in part to a mutual commitment to produce what are in fact the highest practicable safety standards, and in part to the understanding that each state remains free to set its own standards if unsatisfied by those achievable through consensus. Should American agencies undertake joint rulemaking in other settings, they should be alert to this potential "least common denominator" problem.

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[262] A good illustration of the potential gap between American and European regulatory analyses is suggested by Executive Order 12291, of Feb. 17, 1981 (46 Fed. Reg. 13193, Feb. 19, 1981), under which executive agencies like the FAA are required to conduct cost-benefit analyses prior to the issuance of proposed rules and to ensure that the rules would produce a net economic benefit to society. To this end, the FAA Regulatory Handbook (§1-3a) adds that the written justification of any rule "must provide an unbiased, systematic analysis of the rule and its alternatives as well as the consequences of each of the proposed actions and alternatives." At the latest FAA/JAA annual meeting in San Francisco, an FAA official observed:

> The JAA community may be developing alternate criteria for weighing economic factors in rulemaking For harmonization to endure between FARs and JARs, major factors driving regulatory action must also be harmonized to a significant extent. Operating from different fundamental guidelines has the potential to make continued harmonization a difficult task. Therefore it is important to recognize economic differences that drive FAA/JAA standards development and the underlying forces that have led to differences. If there are differences, they should be shared and discussed so that the potential effect on harmonization can be understood. Fundamental differences must be reconciled if harmonization of standards is to be achieved.

Actually, other federal executive orders call for additional regulatory analyses to be performed, and these too may differ from those that foreign agencies are likely to conduct. See E.O. 12498 of Jan. 4, 1985, Regulatory Planning Process (50 Fed. Reg. 1036, Jan. 8, 1985); E.O. 12606 of Sept. 2, 1987, The Family (52 Fed. Reg. 34188, Sept. 9, 1987); E.O. 12612 of Oct. 26, 1987, Federalism (52 Fed. Reg. 41685, Oct. 30, 1987); E.O. 12630 of Mar. 15, 1988, Property Rights (53 Fed. Reg. 8859, Mar. 18, 1988). The Regulatory Flexibility Act of September 19, 1980, 5 U.S.C. §601 et seq., also requires assessment of the impact of proposed rules on small businesses.

In short, it will not do, either in reality or in appearance, for the regulatory standards an agency ultimately adopts to be the product, pure and simple, of intergovernmental negotiations. The FAA, like fellow American agencies and like its own foreign counterparts, works under a statutory mandate which must remain its touchstone so far as the substance of regulatory action is concerned. The zone of compromise within which it may then operate in the interest of commonality with decisionmakers of other nations is necessarily uncertain but necessarily limited. Within that zone, however, harmonization has a significant, possibly even a leading, role to play.

## VIII. Conclusions and Recommendations

The convergence of national airworthiness standards and borrowing of certification services is regarded in practically all quarters as a highly useful development and one to be encouraged. American aircraft manufacturers, who have traditionally dominated the international aviation market, are accustomed to meeting the requirements set by the national aviation authorities in the countries where their products are to be registered. They are understandably wary of any regulatory movement in Europe toward standards that would diverge significantly from those that the FAA imposes on the American aeronautical products market, particularly when the divergences are needless or capable of being bridged. The recent development of an energetic European aircraft industry, itself capable of serving the European market and in fact of invading other markets that American industry long had assumed was its, has not lessened the trend. While European manufacturers might benefit in the short run from regulatory barriers restricting American access to the European market, they have need in the long run for uninhibited access to the American and other world markets. Discrepancies between European and American airworthiness standards thus do not serve their interests particularly well either.

This report has also sought to show that a commonality of standards has spillover advantages with respect to administration and enforcement. The greater the resemblance among national airworthiness standards, the wider the room for play of the bilateral airworthiness agreements that allow one state essentially to borrow conditionally the certification services performed by another. The repair station episode demonstrates that the possibilities for sharing such services are not at present being fully exploited. To the extent that such services can be responsibly and confidently shared, savings to government and the private sector alike may be anticipated.

Unless international collaboration in regulation is viewed as merely a disguised means for exportation of the American system of airworthiness certification, the undertaking implies a willingness to consider seriously the procedures and policies upon which foreign regulatory practice is based. Although it may be reasonably clear in advance that certain national participants will carry greater weight than others in international regulatory efforts, the process presupposes on all sides an attitude of cooperation and mutual benefit. According to one of the architects of the FAA/JAA collaboration, it is essential that each participating authority realize and accept at the outset that its own system will be subject in the process to reexamination and comparison with others, and in the end to some measure of modification.[263]

It is one thing to describe and in most respects applaud the program of cooperative regulation that has been put in place between the FAA and JAA, and another thing to recommend its extension to other regulatory spheres. Any judgment about the utility of this approach to a given sphere requires consideration of the extent to which nations perceive a common interest in joint regulation and are likly to pursue compatible objectives within the framework of such regulation. The case for cooperative regulation in airworthiness has been a very powerful one. As an active supporter of the FAA/JAA venture has expressed it, "the laws of physics and aerodynamics are universal."[264] The case for cooperation in other spheres may be strong but not as strong, and the intensity and regularity of cooperation therefore vary.

In order for any cooperative program to succeed, it must also enlist the political support of regulated interests. Those interests, and indeed all affected interests, must find the resulting regime to be at least as substantively and procedurally advantageous, possibly even more so, as the purely domestic regulatory regime that would otherwise apply.

As in the aviation safety field, so in virtually any other regulatory domain, American regulators will not find their legal or political responsibility diminished due to their cooperation with or reliance on the findings of counterpart agencies abroad. Before an American agency embarks on any such international program, it must therefore assure itself of having an adequate basis for recognizing foreign determinations on matters, such as design or performance, for which the agency will itself ultimately bear responsibility. It also must observe all the otherwise applicable procedural requirements of

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[263] Letter of October 16, 1989, from C. Frantzen (Direction générale de l'aviation civile, service de la formation aeronautique et du contôle technique) to G.A. Bermann.

[264] Sullivan, A Framework for the Development of Compatible Cabin Safety Standards.

American administrative law, except to the extent that the element of intergovernmental cooperation may genuinely be said to take the procedure beyond the reach of those requirements.

As far as specific recommendations are concerned, one should begin with the obvious one that international regulatory cooperation cannot satisfactorily proceed in a climate of regulatory or technological parochialism. The point is too basic to require elaboration. Beyond attitudinal generalities, however, it is possible to identify both the features of FAA/JAA collaboration that have contributed to its apparent success and the precautions that have helped make that collaboration politically acceptable. These observations form the basis of the following recommendations:

1. International regulatory cooperation best succeeds when it has support at the highest domestic regulatory echelons of the agencies involved. It will proceed only haltingly and inconsistently unless it is considered a basically appropriate and "mainstream" approach by those most broadly in charge of the regulatory activity in question. Both process and results will vary according to whether internationalism is the disposition of regulatory leadership as a whole or simply the inclination of a handful of individuals within the regulatory apparatus. An agency's so-called "international specialist"--even an agency unit labelled "foreign liaison" or "international"--easily can remain marginal to the agency's actual mode of operation unless agency leadership shares its outlook and is reasonably committed to it. In the case of the FAA, the program of joint activity with the European authorities has had the support of a succession of FAA administrators.[265]

In determining whether international cooperation deserves genuine priority, an agency should consider the importance or value of regulatory harmonization in its field, the opportunities for international cooperation in enforcement and administration and the extent to which foreign government expertise justifies reliance on its regulatory and enforcement resources. The same considerations should determine the extent of an agency's international cooperation and the selection of foreign governments with which to cooperate.

2. American and European participants alike in the joint airworthiness activities described in this report emphasize the importance of enlisting the support of the FAA's legal department. We have seen that neither the general procedural framework of American administrative regulation nor the particular legal regime governing United States aviation regulation specifically contemplated the conduct of extensive joint certification activities. It would have been entirely understandable for FAA legal counsel to regard that program as on doubtful legal footing and to seek in a variety of formal or

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[265] See, for example, remarks by Admiral James B. Busey, FAA Administrator, *supra* note 110.

informal ways to restrain its development. In fact, FAA lawyers in Washington have chosen to support the process and actually foster it. As a result, the process and its results have not been subjected to after-the-fact misgivings on the part of agency legal officers.[266]

3. Important as the commitment of agency leaders and counsel to international cooperation may be to an agency's program of concerted action, it is essential to recognize that regulators do not operate in a bureaucratic vacuum. The successful conduct and implementation of concerted rulemaking and enforcement require that the regulated interests and the affected public believe that such concerted activity is in principle a useful and legitimate way for the agency to proceed and that the process has actually gone forward with adequate consultation and opportunity for private and public interest participation. It is not possible to describe completely, or in detail, how each agency should seek to ensure such participation within the framework in which it operates. However, it would seem advisable for all potentially affected public and private interests to be advised of the existence of the agency's intergovernmental cooperative arrangements, of the meetings held, working groups established and the like, and also to have an opportunity to participate in these activities to the fullest extent feasible. Done properly, this would promote the transparency and representativeness of these international efforts, and thereby not only enhance them but also enhance the legitimacy of their products. The FAA experience demonstrates that one should not assume that the private sector necessarily must be excluded from intergovernmental efforts of this kind.

Agencies may need to assume more affirmative responsibilities when it comes to integrating public interest representatives in the process. Passenger, pilot and environmental groups, for example, do not have as great a presence in the joint workings of the FAA and JAA and, though there are limits on the extent to which they can feasibly be integrated, additional efforts in that direction could be made.

Depending on the regulatory sphere, other agencies will also have an interest in the nature and extent of intergovernmental consultations that an agency conducts. The State Department always will, and the Commerce Department and USTR almost always. An interagency group should be assembled for any substantial program of intergovernmentalism contemplated by an agency.

4. One way for an internationalized regulatory process and product to win the support of regulated interests is to encourage the latter to operate in parallel fashion and to enjoy the corresponding benefits. Although they function as

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[266] Letter of October 16, 1989, from C. Frantzen (Direction générale de l'aviation civile, service de la formation aeronautique et du contrôle technique) to G.A. Bermann.

competitors in the aeronautical products or aviation services markets, manufacturers and operators within different countries have found that they face similar burdens and challenges from the national regulators in the markets they serve. Just as the FAA and JAA have found that collaboration enhances their effectiveness *qua* regulators, so similarly situated national interests have drawn strength in facing those regulators by jointly articulating their needs and presenting their views to the extent commonalities exist. The point is that possibilities for joint action by different national aeronautical products manufacturers and aviation operators--particularly when closely associated with the concerted activities of the governmental authorities--have increased their willingness to accept both the principles that drive international regulatory cooperation and the regulatory and enforcement results. That in turn has enabled national regulators to cooperate more extensively than would otherwise have been politically possible.

5. As suggested, the strength and intensity of joint rulemaking efforts that can properly occur necessarily depend on the degree of congruence among the regulatory objectives of the participating agencies. The greater the divergence of regulatory objectives, the greater the likelihood that the resulting rule will depart from a given agency's statutory mandate.

Even where the authorities of different countries share similar regulatory objectives at the general level, there is a risk of divergence on any given specific issue and agencies should be alert to that possibility. They should in any event be alert to the possibility that the positions of counterpart agencies abroad will be influenced by domestic economic interests and possibly even reflect protectionist purposes. This is especially so in the regulation of enterprises that in other countries are state-owned or state-controlled. This is not to condemn such influences, much less suggest that they never obtain in the American administrative context, but simply to urge that American agencies engaged in international regulatory cooperation recognize the risk.

6. Although the FAA/JAA experience does not raise the slightest concern on this score, agencies interested in international regulatory cooperation should as a general matter seek to ensure mutuality in the openness of agency rulemaking processes to foreign government and foreign private sector participation. American agencies should not give foreign interests access to their rulemaking where American interests are denied parallel access to foreign government processes. Such imbalance might give an unjustified competitive advantage to foreign industry and other foreign groups, and it would diminish the incentive of foreign authorities to open up their regulatory processes to American participation and influence.

7. International consultations of the sort described in this study do not appear to necessitate any radical departure from an agency's ordinary practices in compliance with applicable procedural statutes. Except where an agency's

consultations bear clearly and directly upon the nation's foreign affairs, the APA exception for such functions should not apply to shelter regulatory action simply because an agency has chosen to internationalize its horizons. Depending on the significance of a regulatory agency's reliance on those consultations, both their fact and substance should figure in the agency's notices of proposed rulemaking, rulemaking records and statements of basis and purposes under the Administrative Procedure Act, and they should be subject both in principle and in practice to meaningful public comment.

By virtue of their more focused insistence on transparency, the Government in the Sunshine and Federal Advisory Committee Acts bear more specifically on interagency consultations on the international level. However, neither of these statutes should as a general matter inhibit consultations of this sort. Even putting aside its very limited scope of application (namely, meetings of collegial agencies), the Sunshine Act only reaches agency gatherings that result in final action within the agency's scope of competence. If they are properly timed as background policy-shaping meetings, and if their conclusions are fully subject to reexamination during the comment period, an agency's prior consultation with foreign counterparts should rarely constitute a gathering subject to the Sunshine Act's advance notice, openness and recordkeeping requirements.

Although their interactions with foreign counterparts closely resemble at times the utilization of advisory committees within the meaning of the Federal Advisory Committee Act, agencies should ordinarily not be held to conform with FACA requirements when engaging in them. Apart from enduring doubts over the government's entitlement to control the structure and operations of advisory groups that it itself has not established, intergovernmental consultations will rarely present the "special" or "private interest" dangers that FACA principally addresses; at the very least the burden of establishing those dangers should fall on those claiming that foreign government agencies should be treated as advisory committees for purposes of FACA. Besides being presumptively unnecessary, efforts to bring an agency's cooperative dealings with counterparts in foreign governments under the extensive and sometimes demanding requirements of a purely domestic statute like FACA would be resented abroad and possibly undermine the cooperative enterprise itself.

The conclusion that the Sunshine Act and FACA do not strictly apply to most agency-level intergovernmental consultations does not mean that agencies should avoid making the fact and tenor of those consultations known to interested groups and to the public in a timely fashion. In fact, their effectiveness and acceptability appear to increase dramatically to the extent that regulated interests are directly enlisted in the authorities' joint study and consultation process itself. To the extent feasible, agencies should seek to ensure that the groups thus enlisted are inclusive of all interests affected and also reasonably representative of them.

8. It stands to reason, and has proved to be the case for the FAA, that international collaboration on any particular matter generally proceeds more satisfactorily when undertaken in the context of concrete and relatively limited problems and when commenced at the outset of that undertaking rather than after national practices have formed and national positions hardened. Modification of existing systems, particularly when originally arrived at on a strictly national basis, has proved more resistant to international consensus than consensual adoption of a common position initially. A related suggestion, therefore, is that agencies committed to an effective program of common study, deliberation or action with foreign counterparts strive at an early date to develop a common agenda that responds to the current interests of both parties, rather than merely one of them. Regulators have found that if they jointly address topics that are not at the time of concurrent mutual interest, the process will not fully engage both and may yield policies or practices that ultimately prove unsatisfactory to the party that did not initially participate fully in addressing them.[267]

9. The FAA's experience has been that if regulatory cooperation with foreign counterpart agencies is approached in an open and respectful manner, then it produces a climate in which further cooperation can flourish.

> As the FAA works with the authorities of other countries...a mutual respect and understanding develops. We come to understand the nuances of each other's regulations, why they differ, and the technical foundations for those differences. We learn the strengths and weaknesses of each other's certification systems and what can be done to reciprocally support each other. We communicate with an increasing efficiency--a particularly important ability when either country's product encounters a serious service difficulty. Finally, each party understands the other's system, regulations, and products well enough to stand behind them and their product when that fortunately rare catastrophic event occurs, and to seek a solution to what created that event.[268]

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[267] *Id.*

[268] Sullivan, A Framework for the Development of Compatible Cabin Safety Standards.

European participants agree that the FAA/JAA partnership has taken time and personal effort to develop. This suggests that while all agencies would do well to consider in comprehensive fashion all the respects in which international cooperation would enhance the performance of their regulatory, administrative and enforcement functions--and at the same time help produce a more orderly international regulatory environment--they should proceed to the establishment of intergovernmental mechanisms on a limited and gradual basis with an eye to what is technologically and politically feasible at any given time. Concrete success in the accomplishment of carefully targeted programs of regulatory or administrative cooperation provides a sounder basis for broader-based intergovernmentalism than an *a priori* commitment to intergovernmentalism on a grand and ambitious scale.

## Report for Recommendation 91-2

# Recommendations for Injecting Needed Openness and Due Process Reforms into United States Export Controls Procedures

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This report was prepared for the consideration of the Administrative Conference of the United States. The views expressed are those of the author and do not necessarily reflect those of the members of the Conference or its committees except where formal recommendations of the Conference are cited.

# Executive Summary

The Export Administration Act (EAA) provides the authority for the President to control the majority of civilian commodities exported from the United States. The law is a unique blend of economic regulation and foreign policy, presenting unusual problems in the reconciliation of these two different legal environments. The aim of the act is to control the export of nonmilitary goods for either national security or foreign policy reasons. The United States generally works with its Western allies in identifying the countries subject to export controls and the types of goods restricted. In theory the EAA requires that virtually every export from the United States be licensed by the Bureau of Export Administration of the Department of Commerce, but only a tiny fraction of exports require any kind of prior approval or document of license.

The EAA was first enacted in 1949 as an outgrowth of the trade controls imposed during World War II. Expanded throughout the Cold War, the act has recently come under scrutiny as United States national security and foreign policy concerns shift from East-West confrontation to regional disputes. The National Academy of Sciences completed a study in early 1991 recommending significant reductions in the extent of controls and reforms in their administration.

Since its enactment the EAA has been exempt from the requirements of the Administrative Procedure Act. Thus the licensing, rulemaking, and enforcement provisions of the law have never had to conform to the requirements of the APA, nor have decisions of the department under the act been subject, until recently, to judicial review. There have been several proposals in the 40 years since enactment to remove the APA exemption, or open the process up to judicial review. Until 1988 none had been successful. At that time, Congress provided that enforcement decisions, including temporary denials of export licenses done on an *ex parte* basis, could be appealed to the District of Columbia Circuit Court of Appeals. While there have been other procedural reforms under the act, the Commerce Department is still operating outside the framework of the APA with no judicial review available for the majority of decisions it makes implementing the EAA. The National Academy of Sciences study recommended repeal of the exemption from the APA, and that is the central recommendation of this study.

An exporter seeking a license from the department must first determine which category of technology her product falls into. The Commodity Control List maintained by Commerce is the basis for the system of controls. While each exporter is expected to classify her product, Commerce will verify or revise the classification. Once the classification is determined, the exporter must review the control regulations to see if an individual validated license is required. If it is, the exporter will file an application indicating the end-user, particular end-use, and country of destination.

Commerce reviews these applications and examines all elements of the transaction. Policy attitudes toward particular countries and national security classified information about the country or end-user play a role in Commerce's decision to grant or deny the license, as do the views of the departments of State and Defense. When Commerce makes a decision, the exporter is provided only the most summary explanation. The decision can be appealed within the department to an assistant secretary, but that official may have been involved in the initial decision if it was a sensitive issue. Judicial review of licensing decisions is not available.

The primary flaw in the current system is the absence of judicial review. Commerce has never had to be concerned about justifying decisions adverse to exporters outside the department. Congress' decision to exempt the Export Administration Act from judicial review was made immediately after World War II when the law was regarded as an emergency statute (and judicial review under the APA a novel concept). While there are significant foreign policy issues involved with administration of the law, courts deal with these frequently in other contexts, and have shown deference to the executive on the most sensitive issues when required.

Another problem that is an outgrowth of the lack of judicial review is the absence of official explanations on the record of adverse actions. This seriously hampers the existing internal appeals process and would make judicial review very difficult. A related problem is the absence of information about how Commerce has treated other exporters in licensing situations, making it extremely difficult to determine if Commerce is treating similarly situated parties the same.

The final problem is that the relatively small size of the agency and the numerous levels of supervision combine with substantial amounts of informal discussion of issues to make internal appeals to neutral officials very difficult. Because the system has so long operated on an informal basis, and sensitive questions are considered initially at very high levels, meaningful administrative appeal and review is often unavailable.

The recommendations for reform based on this report range from the broadest statutory change (repeal of the APA exemption) to internal reforms designed to provide more explanation to affected exporters. The objective is to get Commerce to explain its decisions on the record and create an option for judicial review of these explanations. Judicial review by the Court of Appeals for the Federal Circuit is recommended to facilitate the process and put review in the hands of the court most experienced with foreign economic policy and advanced technology questions. The internal reforms recommended will also lead to the creation of a reviewable record, since the process will not include a formal APA adjudication that is the traditional basis for appellate court review. Special attention is devoted to problems relating to the national security classified information involved in the process and the foreign policy nature of the issues.

Adoption of the recommendations should provide American exporters the degree of procedural fairness they have come to expect under our system of administrative law, while respecting the critical foreign policy objectives of the statute.

# I. Introduction

Within the past 2 years the United States has begun to radically redefine its concept of national security. The demise of the Soviet Union and Warsaw Pact as the principal adversary in a bipolar world and the emergence of regional antagonists such as Iraq compel a review of many of the assumptions this country has made about protecting itself from foreign threats. Nowhere is this more apparent than in the changing views of Congress and the executive branch about political controls over international trade. No longer can we concentrate our efforts on depriving the communist bloc of our newest technology. The threats we are likely to face in the future are from new enemies wielding technology that is no longer the exclusive domain of the Western allies.

The United States has an opportunity now to reassess both the broad substance of its restrictions on foreign trade and the severe administrative due process limitations imposed upon its foreign traders. The National Academy of Sciences has recently issued its comprehensive reassessment of national security and foreign policy export controls and recommendations for fundamental change.[1] The Bush Administration however has adopted expansive new export controls on material that could be used for chemical or biological weapons or missile technology, greatly expanding the transactions subject to controls.[2] The Administrative Conference of the United States commissioned this study to assess the need for procedural changes in the

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*This report was prepared on behalf of the Administrative Conference of the United States. It was prepared, in part, based on my extensive interviews with current and former personnel of the Bureau of Export Administration, United States Department of Commerce, and with private attorneys and corporate officials specializing in export control matters. The conclusions and recommendations are solely my own except to the extent they have been adopted by the Conference. I would like to thank my very valuable student research assistants Mr. Todd Kitchen and Mr. Michael Anderson for their help on this project. Ms. Candace Fowler, staff attorney for the Conference and Professor Peter Strauss, chair of the Judicial Review Committee provided substantial guidance and assistance to me in preparing this final report.

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[1] National Academy of Sciences, Finding Common Ground: United States Export Controls in a Changed Global Environment (1991) (hereinafter cited as "NAS Study").

[2] 56 Fed. Reg. 10,760 (March 13, 1991). *See, United States Announces New Controls on Exports of CBW - Related Goods, Missile Technology*, INT'L TRADE REP. (BNA) Vol. 8, No. 11 at 376 (March 13, 1991). *See also* De Vaughn, *Summary of United States NonProliferation Controls* (125-46) in Coping with United States Export Controls 1991 (Berlack & Hunt ed. 1991) (hereinafter cited as "Coping with United States Export Controls 1991").

existing export control regime, a system now characterized by arbitrariness and absence of recourse. The goal of reform for both the substance and procedure of American export controls has to be a system of regulation that protects legitimate national security or foreign policy concerns while not unnecessarily depriving United States firms of commercial opportunities or of administrative due process and fairness. While taking the foreign policy concerns into consideration, this report recommends reforms in the procedures of the current export control system that bring it much closer to the standards of procedural fairness and due process typically associated with the American system of administrative law and regulation.

Procedural and substantive rights have been sacrificed in a number of different contexts because of national security concerns raised by the Cold War. The right or ability to travel,[3] to hold a government job,[4] to come into[5] or stay in[6] the country, and to obtain access to government records[7] were summarily restricted in the name of national security. Perhaps most anomalous in our market-oriented system were the broad restrictions placed on United States exporters through the export control system and the scanty protection made available from arbitrary government actions. Under the national security justification, the legal regime governing exports from the United States remains the most durable bastion of the privilege versus right distinction in the regulation of commerce today.

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[3] *Reagan v. Wald*, 468 United States 222 (1984); *Zemel v. Rusk* 381 United States 1 (1965). These cases both involved applications for passports to Cuba and restrictions under the Trading with the Enemy Act, 50 U.S.C.A. app. §§1 *et seq.* (West Supp. 1990). The application of travel restrictions requires at least minimal due process because the right to travel has been accorded constitutional status. *Kent v. Dulles* 357 United States 116 (1958). *See* Boudin, *Economic Sanctions and Individual Rights*, 19 J. INT'L L. & POL. 803 (1987).

[4] *Department of the Navy v. Egan* 484 United States 518 (1988); *Cafeteria Workers v. McElroy* 367 United States 886 (1961). Both decisions involved loss of employment based on denial of a security clearance. *See generally* Jaksetic, *Security Clearance Determinations and Due Process*, 12 GEO. MASON U.L. REV. 171, 188-206 (1990).

[5] 8 U.S.C.A. §1182(a)(27)-(29) (West Supp. 1990). *See Rafeedie v. Immigration and Naturalization Service* 688 F.Supp. 729, 749-51 (D.D.C. 1988), aff'd in part, rev'd in part and remanded 880 F.2d 506, 523-29 (D.C.Cir. 1989). Notwithstanding the summary authority of the INS, permanent resident aliens receive significantly greater due process in exclusionary proceedings than export license applications.

[6] *Jay v. Boyd* 351 United States 345 (1956); *Azzouka v. Meese* 820 F.ed. 585 (2nd Cir. 1987). 8 U.S.C.A. §§1252-53 (West Supp. 1990).

[7] 5 U.S.C.A. 552(b)(1)(A) (West Supp. 1990)(Freedom of Information Act national security exemption. *See also* Exec. Order No. 12,356, 47 Fed. Reg. 14,874 (Apr. 2, 1982); *National Federation of Federal Employees v. United States* 688 F.Supp. 671 (D.D.C. 1988), *vacated sub nom., American Foreign Service Organization v. Garfinkel*, 490 United States153 (1989) (challenges to federal employee agreements limiting disclosure of national security information).

The principal vehicle for regulation of American civilian exports is the Export Administration Act.[8] This law applies primarily to "dual use" exports, those that are not weapons or munitions, but that could be used to advance or promote the military potential of an adversary state.[9] Exports of munitions are subject to an alternative regulatory regime administered by the State Department.[10] This study focuses on the Commerce Department's administration of the Export Administration Act (EAA), the most intrusive and pervasive export control system.

The EAA is a direct outgrowth of the World War II system of economic controls. Its forerunner, the Export Control Act of 1949, perpetuated a wartime system that gave broad powers to the President to restrict the export of goods and technology. The primary stated purpose of the law in 1949 was to protect against domestic shortages and allocate United States resources to rebuild Europe under the Marshall Plan. A secondary but growing rationale was to deny the advanced technology of the United States to those nations of Eastern Europe that would employ it to threaten national security. During the Cold War, the focus of the EAA shifted to prohibiting Soviet Bloc access to Western goods and technology that might improve its military capabilities. The basic structure of the 1949 act remains today. While the objectives of the law in 1991 have begun to shift from bipolar national security concerns to regional foreign policy and weapons proliferation concerns, the operating procedures of the EAA continue to reflect their origins in the Cold War.

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[8] 50 U.S.C.A. App. §§ 2401 *et seq.* (West Supp. 1990). There are a variety of other, lesser control schemes scattered across the government. *See* Hunt, *The Export Licensing System* in Coping with United States Export Controls 1990 13-15 (Berlack & Hunt ed. 1990) (hereinafter cited as "Coping with United States Export Controls 1990").

[9] "(2) It is the policy of the United States to use export controls only after full consideration of the impact on the economy of the United States and only to the extent necessary-- (A) to restrict the export of goods and technology *which would make a significant contribution to the military potential of any other country or combination of countries which would prove detrimental to the national security of the United States*;

(B) to restrict the export of goods and technology *where necessary to further significantly the foreign policy of the United States* or to fulfill its declared international obligations; (emphasis added).

50 U.S.C.A. app. §240B(2) (West Supp. 1990). *See* Hunt, *The Export Licensing System* in Coping with United States Export Controls 1990, *supra* note 8 at 13.

[10] International Security Assistance and Arms Export Control Act of 1976, 22 U.S.C.A. §§ 2778 *et seq.* (West Supp. 1990); implementing rules in International Traffic in Arms Regulations (ITAR) 22 CFR 120-130 (1990). In February 1990 the Center for Defense Trade was created at the State Department with responsibility for munitions controls, replacing the Office of Munitions Control that had administered the ITAR for years.

The Export Administration Act is a unique blend of economic regulation and foreign policy initiative. Because of its origins as an emergency statute during World War II, it has always been exempt from the requirements of the Administrative Procedure Act (APA).[11] Until 1988 there was no meaningful avenue of judicial review for any decision made by Commerce under the EAA.[12] While the Commerce Department and the Congress have made piecemeal reforms in procedures in recent years,[13] the hallmark of the export control system has been the finality of decisions reached by the department.

The federal courts as well as the Congress have long recognized that regulatory questions relating to foreign and military affairs fall within the purview of the executive branch.[14] The courts in particular have been reluctant to second guess the President in matters of foreign affairs. On the other hand, the courts and Congress have established rigorous procedural standards for government economic regulation.[15] Where economic regulation and foreign policy intersect in import trade law and policy and in customs law and practice, Congress has provided a broad range of guarantees against regulatory excess. These protections include specialized federal courts dedicated to providing judicial relief, the Court of International Trade and the Court of Appeals for the Federal Circuit.[16] On the export side, where emergency rules and the national security rationale have dominated, the combination of economic regulation and foreign or military affairs policy that makes up the export control system has been excluded from regulatory due process requirements and judicial review. In the over 40 years the program has operated, the rationale for this exemption and its impact have never been seriously questioned. As the principal international threat to United States security recedes, the entire framework of national security export controls is coming under scrutiny. The presumption that these controls can only be administered free of judicial oversight and other traditional notions of administrative process should also be questioned.

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[11] 5 U.S.C.A. §§551 *et seq.* (West Supp. 1990).

[12] Enforcement actions by the department were made reviewable for the first time in the D.C. Circuit Court of Appeals, Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 13(c), 102 Stat. 1325, 1325-72 (1988).

[13] *See* notes 82-97 and accompanying text *infra*.

[14] *See generally* Henkin, Foreign Affairs and the Constitution 44-54 (1972).

[15] The Administrative Procedure Act, 5 U.S.C.A. §552 *et seq.* (West Supp. 1990) provides the procedural framework for government regulation. For a recent, comprehensive overview of this process *see* Strauss, An Introduction to Administrative Justice in the United States (1989).

[16] The Court of International Trade is the successor to the United States Customs Court, possessing substantially broader jurisdiction and authority over matters relating to foreign trade. It was created by the Customs Courts Act of 1980, Pub. L. No. 96-417, 94 Stat. 1727 (1980), codified at 28 U.S.C.A. §1561 (West Supp. 1990). The Court of Appeals for the Federal Circuit was created through a merger of the Court of Claims and Court of Customs and Patent Appeals by the Federal Courts Improvement Act of 1982, Pub. L. No. 97-164, 96 Stat. 26, codified at 28 U.S.C.A. §1295 (West Supp. 1990). These courts consider import issues arising under United States customs law as well as issues concerning unfair trade practices such as dumping goods into or subsidizing exports to the United States, under the 1979 Trade Agreements Act, Pub. L. No. 96-39, 93 Stat. 144 (1979), codified at 19 U.S.C.A. §§2501 *et seq.* (West Supp. 1990). *See* text accompanying notes 247 to 252 *infra*.

The operating premise for the Export Administration Act is that the federal government controls all exports from the United States. The Department of Commerce administers the act on the basis that exporting is a privilege flowing from the federal government and that all exports from the United States must be licensed.[17] The vast majority of these exports are granted one of a variety of general licenses under the Export Administration Regulations (EAR), which require no express approval or permission from Commerce.[18] Those items that are subject to export controls by the United States require an individual validated export license issued by the Bureau of Export Administration (BXA), indicating that the specific transaction has been approved by the Commerce Department prior to shipment.[19] The heart of this system is the list of commodities that the government wishes to regulate (the Commodity Control List or CCL).[20] The United States works in consultation with its Western allies through an organization called the Coordinating Committee on Multilateral Export Controls, or CoCom, to determine the nature of the technology that should be on this list.[21] The government, again in consultation with CoCom, maintains a list of countries, arranged in various groupings, that are the target of export controls.[22]

An exporter of a controlled item must first identify its category of technology to ascertain the extent of the restrictions placed on it. If a validated license is required, the exporter must file an application with BXA indicating the country and customer or enduser in that country. BXA will grant or deny the license based on a variety of factors including concerns about the proposed and actual use of the commodity, opposition from the Departments of Defense or State, classified information about the enduser, or policy determinations about the country. Classification of the product or denial of the license can be appealed from the staff level to an assistant secretary, but that determination is final.[23]

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[17] 15 CFR §770.3(a)(1990)("subject to the provisions of §§770.04, 770.5, and 770.6, the export from the United States of all commodities, and all technical data as defined in §779.1, is hereby prohibited unless and until a general license authorizing such export shall have been established or a validated license or other authorization for such export shall have been granted by the Office of Export Licensing . . . ") *See also* Baird, *Export Licensing: An Overview* in Coping with United States Export Controls 1990, *supra* note 8 at 61-63. Iain Baird is the director of the Office of Export Licensing in the Bureau of Export Administration.

[18] 15 CFR §771.1 (1990).

[19] 15 CFR §772 (1990).

[20] 15 CFR §799.1, See Hunt, *The Export Licensing System* in Coping with United States Export Controls 1990, *supra* note 8 at 23-24.

[21] Hunt, *CoCom and Other International Cooperation in Export Control* in Coping with United States Export Controls 1991, *supra* note 2 at 99-124.

[22] 50 U.S.C.A. app. §2403(b) (West Supp. 1990).

Violations of the act can result in civil penalties of $10,000 per violation, criminal penalties exceeding $1 million and 5 years in prison, and denial of export privileges.[24] Until 1988, export denials were not subject to any kind of judicial review,[25] while civil penalty determinations were reviewable only through a convoluted collection process.[26] The administration of the EAA is a relatively involved regulatory program with serious penalties for violations, but the classification and licensing process, as well as the enforcement scheme, are not dissimilar from the administrative functions of other agencies.[27] Yet Commerce Department actions have been expressly exempted from the Administrative Procedure Act almost from the inception of postwar export controls.[28]

At the end of World War II, Congress regarded the existing system of export controls as temporary, emergency measures. The 1946 enactment of the Administrative Procedure Act contained exceptions for emergency war measures,[29] and for those rulemaking and adjudicative measures involving the military or foreign affairs functions of the government.[30] It is curious that Congress nonetheless felt compelled to exempt the administration of export controls from the APA. While the original exemption contained in the Second Decontrol Act of 1947, enacted barely a year after the APA itself, did not exempt export control functions from the judicial review provisions of the APA, the Export Control Act of 1949 eliminated even that constraint on Commerce Department action.[31] The effect of the APA exemption has been that for the past 40 years the Commerce Department has been left to its own devices in developing administrative procedures, free from the requirements of the APA or of judicial oversight subject only to occasional congressional comment during the periodic renewals of the statute.[32]

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[23] 15 CFR §789 (1990).

[24] 50 U.S.C.A. app. §2410 (West Supp. 1990).

[25] Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, §13(c), 102 Stat. 1325, 1325-72 (1988), codified at 50 U.S.C.A. app. §2412 (West Supp. 1990).

[26] 50 U.S.C.A. app. §2410(f) (West Supp. 1990).

[27] The classification process bears strong resemblance to the process used in Customs classification of products to determine the appropriate tariff. The process involves identifying which narrative description of a type of product on either the Commodity Control List or Harmonized Tariff-System list most closely matches the product in question. The licensing aspect of the regime is somewhat more unusual in that it involves prior approval of a large volume and wide range of individual transactions or activities. With regard to number and significance of decisions, the process resembles Immigration and Naturalization Service functions. The range of value of transactions affected, from virtually no-value provisions of some technical data to multi-million dollar sales of equipment, may be unique, but there are parallels throughout governments. It is unusual, however, to have one agency licensing such a diverse range of transactions. With regard to enforcement, only the occasional use of national security classified information distinguishes the program at all from the rest of government regulatory enforcement efforts.

[28] Export Control Act of 1949, Pub. L. No. 81-11, §7 (1949).

[29] Pub. L. No. 79-404 §2(a) (1946) now codified at 5 U.S.C.A. §551 (West Supp. 1990).

Because of the sweeping nature of this exemption, there has been no occasion to explore which aspects of the administration of export controls under the EAA could properly be reviewed, or which elements could be administered consistent with APA standards notwithstanding their national security or foreign policy implications. In a definitive 1967 Columbia Law Review article on the history and future of export controls, Harold Berman and John Garson argued for repeal of the APA exemption when the EAA was renewed in 1969.[33] In 1986 the American Bar Association passed a resolution recommending the repeal of the exemption from judicial review contained in the EAA.[34] The 1990 House of Representatives bill extending the EAA included repeal of the judicial review exemption[35] although the House-Senate

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[30] *Id.* §§4,5; §§553-54.

[31] Export Control Act of 1949, Pub. L. No. 81-11, §7 (1949).

[32] *See* Malloy, Economic Sanctions and United States Trade, 38-78 (1990) (hereinafter "Malloy") (detailed legislative history of EAA revisions).

[33] Berman & Garson, *United States Export Controls--Past, Present and Future* 67 COLUM. L. REV. 791, 884-87 (1967) (hereinafter "Berman & Garson"). The authors were reluctant to recommend opening up individual licensing decisions to judicial review, however, a step this proposal recommends.

[34] "BE IT RESOLVED that the American Bar Association recommends that the United States Congress amend section 12(a) of the Export Administration Act of 1979, 50 U.S.C. App. §2412(A) (1982), as amended, to eliminate the exemption of agency action under the Act from judicial review, except as to foreign policy or national security policy judgments." International Law and Practice Section, Report No. 113 B, Summary of Action of the House of Delegates 25, (ABA Annual Meeting August 11-13, 1986).

[35] Sec. 18. JUDICIAL REVIEW.

(a) JUDICIAL REVIEW. --(1) 13(a) (50 U.S.C. App. 2412(a)) is amended to read as follows:

"(A) APPLICABILITY.--

conference bill dramatically weakened this provision,[36] and that bill was pocket-vetoed by the President.[37] The 1991 National Academy of Sciences recommendations included an express call for the repeal of the broad exemption from the APA, not just the judicial review exemption.[38] As appealing as these simple approaches are, sorting out those administrative functions that are in need of reform, or those issues that courts could usefully review is a somewhat more complicated task, and this report concludes with somewhat more complex recommendations. This report examines the specific functions of the Bureau of Export Administration at the United States Department of Commerce in administering the EAA and isolates, to the extent possible, those functions that involve national security or foreign policy considerations and those which are more purely administrative in nature. The report explores the application to BXA of traditional forms of control of the regulatory process, including judicial review, identifying those that are consistent with the national security and foreign policy components of that administration. The report concludes with a series of relatively detailed recommendations to conform the procedures to contemporary concepts of fairness and administrative due process in the regulation of United States business.

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"(1) EXEMPTIONS FROM ADMINISTRATIVE PROCEDURE.--Except as provided in section 11(c)(2) and subsection (C) of this section, sections 551 and 553 through 559 of title 5, United States Code, do not apply to the functions exercised under this Act.

"(2) JUDICIAL REVIEW.--(A) Subject to subparagraphs (B) and (C) and to subsection (c), judicial review of actions under this Act shall be pursuant to chapter 7 of title 5, United States Code.

"(B) Any discretionary determination of whether an item should or should not be on the control list shall not be subject to judicial review.

"(C) An action to obtain judicial review under this subsection may be brought in the appropriate United States district court.".

H.R. 4653, 101st Cong., 2d sess. 136 Con. Rec. H3343-54 (1990). The exemption from review of the decision whether an item should or should not be on the control test is ambiguous. At its narrowest reading it would properly have the courts defer to the Commerce Department's decision as to what level of technology to control. At its broadest, it could render all classification decisions by Commerce unreviewable (as individual decisions about whether the item should be controlled). The provision would also place review in the federal district courts without any guidance as to the standard for review. Presumably these courts would have to engage in *de novo* review of the agency action.

[36] Omnibus Export Amendments Act of 1990, H.R. Rep. No. 944, 101st Cong., 2d sess. §124 (1990).

[37] Memorandum of Disapproval, Nov. 16, 1990 reprinted in Coping with United States Export Controls 1991 *supra* note 2 at 529.

[38] NAS Study, *supra* note 1 at 193.

# II. The Right to Export and the Peculiar Procedures of United States Export Controls

## A. The Right to Export - Absence of a Legal Context

The development of administrative law since the end of World War II has been closely intertwined with the recognition of rights and interests under the Constitution requiring due process. There appears to be neither a constitutional nor statutory right to engage in export trade that compels any process or procedure protecting it. The history of United States export controls reveals little concern for protecting the interests of exporters. When the Supreme Court had occasion to review an early example of export controls in *United States v. Curtiss Wright Export Corp.*,[39] Justice Sutherland explored an entirely new territory of foreign affairs authority for the President. The extra-constitutional grounds Sutherland discovered for presidential action have provided the basis for the subordination of commerce to foreign policy in this context. While there is a provision of the Export Administration Act entitled "Right of export",[40] it describes the importance of exporting but then qualifies the ability of Americans to export by incorporating the 15 separate policy statements justifying the controls that preface the act.[41] The Constitution contains an explicit reference to federal government restrictions on exports in Article 1, Section 9: "No tax or duty shall be laid on articles exported from any state."[42] While there is language in Supreme Court decisions that seems to support a broad interpretation of this clause as prohibiting any restrictions on exports,[43] or creating a right to export,[44] these are exclusively economic regulation cases. There is some evidence that the drafters of the Constitution meant to preclude restrictions promulgated under the federal government's war powers from this ban.[45] There is little doubt that between the authority of the Congress to regulate foreign commerce[46] and the President's authority to

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[39] United States v. Curtiss-Wright Export Corp., 299 United States 304 (1936).

[40] 50 U.S.C.A. app. §2403(d) (West Supp. 1990).

[41] 50 U.S.C.A. app. §§2403 (1)-(15) (West Supp. 1990). Those policies that appear most contradictory to any statutory "Right" of export are:

* * *

> "(2) It is the policy of the United States to use export controls only after full consideration of the impact on the economy of the United States and only to the extent necessary-
>
> (A) to restrict the export of goods and technology which would make a significant contribution to the military potential of any other country or combination of countries which would prove detrimental to the national security of the United States;
>
> (B) to restrict the export of goods and technology where necessary to further significantly the foreign policy of the United States or to fulfill its declared international obligations; and
>
> (C) to restrict the export of goods where necessary to protect the domestic economy from the excessive drain of scarce materials to reduce the serious inflationary impact of foreign demand.

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> (3) It is the policy of the United States (A) to apply any necessary controls to the maximum extent possible in cooperation with all nations, and (B) to encourage observance of a uniform export control policy by all nations with which the United States has defense treaty commitments or common strategic objectives
>
> (4) It is the policy of the United States to use its economic resources and trade potential to further the sound growth and stability of its economy as well as to further its national security and foreign policy objectives.
>
> * * *
>
> (7) It is the policy of the United States to use export controls, including license fees, to secure the removal by foreign countries of restrictions on access to supplies where such restrictions have or may have a serious domestic inflationary impact, have caused or may cause a serious domestic shortage, or have been imposed for purposes of influencing the foreign policy of the United States. In effecting this policy, the President shall make reasonable and prompt efforts to secure the removal or reduction of such restrictions, policies, or actions through international cooperation and agreement before imposing export controls. No action taken in fulfillment of the policy set forth in this paragraph shall apply to the export of medicine or medical supplies.
>
> (8) It is the policy of the United States to use export controls to encourage other countries to take immediate steps to prevent the use of their territories or resources to aid, encourage, or give sanctuary to those persons involved in directing, supporting, or participating in acts of international terrorism. To achieve this objective the president shall make reasonable and prompt efforts to secure the removal or reduction of such assistance to international terrorists through international cooperation and agreement before imposing export controls."

* * *

[42] United States Const. art. I, §9.

[43] "The requirement of the Constitution is that exports should be free from any governmental burden." Fairbank v. United States, 181 United States 283, 289 (1901).

[44] *See* Armour Packing Company v. United States, 209 United States 56, 79 (1908); Gibbons v. Ogden, 22 United States 1, 119 (1824).

[45] *See* Note, *Constitutionality of Export Controls*, 76 YALE L. J. 200, 208 (1966).

[46] United States Const. art. I, §8.

conduct military and foreign affairs,[47] export controls for military or foreign policy objectives are valid exercises of power. The *Curtiss-Wright* decision involved the question of Congress' delegation of legislative authority to the President to ban arms exports to nations involved in a dispute in South America. The Supreme Court in its 1936 opinion had little trouble with the delegation question,[48] at a time when the issue was hotly contested in domestic circumstances.[49] Justice Sutherland based his opinion in large part on his view that the President's authority in foreign affairs was grounded in principles broader than the Constitution and not subject to its limitations.[50] While not without its detractors,[51] this view has provided a powerful argument for courts deferring to executive exercises of authority in the area of foreign affairs, especially under color of even the vaguest Congressional grant.[52]

## B. Brief History of Export Control Laws

The United States Government has enthusiastically embraced economic sanctions throughout its history,[53] imposing embargoes and boycotts during the American Revolution, the War of 1812 and the Civil War (in conjunction with a blockade).[54] Export controls as a specific device outside the broader framework of a general embargo first appeared during the Spanish-American War in 1898. Congress passed a joint resolution which provided: "That the President is hereby authorized, in his discretion, and with such limitations and exceptions as shall seem to him expedient, to prohibit the export of coal or other material used in war from any seaport of the United States until otherwise ordered by Congress."[55] The scope and precision of Congressional controls enacted since this resolution have only marginally improved.

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[47] United States Const. art. II, §2.

[48] United States v. Curtis-Wright Export Corp., 299 United States 304, 327-29 (1936)

[49] *See* Schecter Poultry Corp. v. United States, 295 United States 495 (1935).

[50] United States v. Curtis-Wright Export Corp., 299 United States 304, 319-20 (1936). *See* Henkin, *supra* note 14 at 19-24.

[51] *Id.* at 23-25. *See generally* Lofgren, *United States v. Curtis-Wright Export Corp.: An Historical Reassessment* 83 YALE L. J. 1 (1973).

[52] *See* Malloy *supra* note 32 at 537-38.

[53] *See* Carter, International Economic Sanctions: Improving the haphazard United States legal regime 8-10 (1988); *see also* Malloy *supra* note 32 at 186-194.

[54] *See* Hufbauer & Schott, Economic Sanctions Reconsidered: History and Current Policy 4-8, 22-24 (1985).

[55] "Ban on Coal and War Materials" Cong. Joint Res. No. 25, Pub. L. No. 11 (1898). *See* Berman & Garson, *supra* note 33 at 791-93.

In 1912 the resolution was amended to expand the President's authority to bar exports of arms and munitions to any nation in the hemisphere where they might be used to promote violence. Criminal penalties of fines up to $10,000 and imprisonment up to 2 years were added.[56] The Curtiss-Wright Company was found to have violated regulations promulgated under this order, resulting in the famous decision discussed above establishing the unreviewable nature of these matters. The first extensive codification of authority for economic sanctions came in 1917 as an outgrowth of World War I, with passage of the Trading With the Enemy Act (TWEA).[57] This detailed the restrictions that could be imposed, a licensing process, and penalties for violation.[58] Significant restrictions on foreign trade still exist today under this statute.[59] The United States made additional forays in the export control area with a 1925 restriction on helium exports (out of concern over a "blimp gap" )[60] and a 1935 resolution banning arms exports to the European belligerents.[61] With the onset of the Second World War, Congress enacted new authority for the President to restrict the export of weapons and the tools for their manufacture.[62] In 1942 this law was amended to extend the President's authority to ban the export of "any articles, technical data, materials or supplies."[63] This is the basic export control authority that exists today.[64]

## C. The Other Export Control Regimes

The Export Administration Act and Regulations administered by the Commerce Department are the primary rules exporters of nonmilitary goods must deal with. They are the body of rules that apply to virtually every civilian export transaction between American businesses and customers in nations not totally blocked from trade with the United States. However the State Department regulates the extensive United States trade in munitions,[65] and the Treasury controls trade, including exports, with nations subject to near-total embargoes.[66] There are other export controls scattered throughout the government, but the state and Treasury programs are the most significant after the EAA.[67]

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[56] Cong. Joint Res. No. 10 amending No. 25, (1912).

[57] Pub. L. No. 65-91, (1917). *See* Malloy, *supra* note 32 at 136-144.

[58] *Id.*

[59] 50 U.S.C.A app. §§1 *et seq.* (West Supp. 1990).

[60] Pub. L. No. 68-544, (1925).

[61] Cong. J. Res. No. 67, Ch. 837 (1935).

[62] "An Act to Expedite the Strengthening of the National Defense" Ch. 508, 54 Stat. 12 (1940). *See* Berman & Garson, *supra* note 33 at 792.

[63] Ch. 461, 56 Stat. 463 (1942). *See* Berman & Garson, *supra* note 33 at 792.

[64] 50 U.S.C.A app. §2401 *et seq.* (West Supp. 1990).

[65] International Security Assistance and Arms Export Control Act of 1976, 22 U.S.C.A. §2778 *et seq.* (West Supp. 1990).

The State Department licenses all munitions exports from the United States under the Arms Export Control Act[68] and International Traffic in Arms Regulations.[69] Exporters of munitions must register with State.[70] If an item appears on the Munitions List, the exporter must obtain a license from the Center for Defense Trade prior to export.[71] The requirement for a written license does not vary depending upon country of destination, or with the sophistication of the technology involved. The overwhelming majority of end-users of munitions are foreign governments or their political subdivisions. The Center for Defense Trade handles approximately 60,000 licenses per year.[72] Licensing decisions are based on both national security and foreign policy concerns relating to foreign access to American weaponry.[73]

Once the exporter determines that her product is on the Munitions List, she knows that a license is required (if the item is not on the Munitions List, the exporter must still check to see if it is covered by the Export Administration Regulations). The classification process at State is relatively simple compared to the more complex situation at Commerce that involves both the nature of the technology and the country of destination.

The Treasury Department administers controls over United States foreign trade through its Office of Foreign Assets Control, which implements provisions of the Trading with the Enemy Act[74] and International Emergency Economic Powers Act.[75] Export (and import) restrictions administered by OFAC are country-specific and categoric (i.e., barring virtually all trade with target countries).[76] Current examples include Cuban and Vietnamese controls, and the somewhat more complex South African anti-apartheid controls. Licenses may be sought for transactions, within recognized exceptions such as for humanitarian needs, or for other compelling circumstances.[77] The controls are imposed in direct response to actions by the target country adversely affecting United States interests and are, at least in theory, short-term restrictions aimed at achieving particular foreign policy objectives.

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[66] 31 CFR §500 *et seq.* (1990).

[67] *See* 15 CFR §770.10 "Exports which are not controlled by Export Administration"(1990).

[68] 22 U.S.C.A. §2778 *et seq.* (West Supp. 1990).

[69] 22 CFR 120-30 (1990).

[70] 22 U.S.C.A. §2778(b)(1)(A) West Supp. 1990.

[71] 22 CFR 120-30 (1990). In February 1990 the Center for Defense Trade was created at the State Department with responsibility for munitions control, replacing the Office of Munitions Control.

[72] *See The Bottom Line: Fast Licensing*, DEFENSE TRADE NEWS, United States Dept. of State at 4 (Sept. 1990).

[73] 22 U.S.C.A. §2778 (West Supp. 1990).

[74] 50 U.S.C.A. app. §1 *et seq.* (West Supp. 1990).

[75] 50 U.S.C.A. §1701 *et seq.* (West Supp. 1990).

[76] 31 CFR §500.201 (1990). *See generally* Malloy *supra* note 32 at 136-48.

Administration of Treasury controls is simplicity itself compared to Commerce rules. Because Treasury rules are country restrictions, questions of their applicability are easily resolved. The need for a license does not depend on the nature of the transaction or product since all commercial intercourse with the target country is subject to licensure, and almost all is banned.

Unlike the Export Administration Act, neither the State nor Treasury export control regimes are expressly exempt from the Administrative Procedure Act. Treasury relies very heavily on interpretive rules for its implementation of TWEA and IEEPA controls. State decisions about which items are military in character are exempt from APA rulemaking requirements as military or foreign policy decisions. Congress has recently expressly exempted these determinations from judicial review because of their integral relationship with Commerce's commodity classification list determinations,[78] even though courts had shown no interest in second-guessing the State or Defense departments on these matters.[79] License denials by State and Treasury are theoretically subject to judicial review, but such action is uncommon. Treasury has been reversed before,[80] but only rarely. There are no reported cases of munitions license denial appeals.

Both the State and Treasury regimes have been criticized for delays and arbitrariness in their licensing programs. Both operations are much smaller and less elaborate than the Bureau of Export Administration at Commerce. Neither has as well-developed internal procedures, although all three bureaucracies can be characterized by the informal review process that operates for adverse licensing decisions.

At a very basic policy level, the export control programs at State and Treasury can be distinguished from the Commerce program. Both State and

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[77] 50 U.S.C.A. §1702(b) (West Supp. 1990).

[78] The Anti-Terrorism and Arms Export Amendments Act of 1989 Pub. L. No. 101-222, §6; 103 Stat. 1892 (1989) codified at 22 U.S.C.A. §2778 (h) (West Supp. 1990). This change was made to maintain consistency in executive determinations about whether items were under Commerce jurisdiction on the CCL or State jurisdiction on the munitions list since commerce CCL determinations were not subject to judicial review. *See* 135 CONG. REC. S.16578-81 (daily ed. Nov. 21, 1989) (Statement of Sen. Riegle).

[79] United States v. Martinez, 904 F.2d 601, 602 (11th Cir. 1990).

[80] *See e.g.*, Real v. Simon, 510 F.2d 557 (5th Cir. 1975).

Treasury regimes involve the implementation of basic military or foreign policy decisions through control of trade. State decides which countries shall have access to which types of American military know-how. Treasury screens those transactions that shall be permitted in the face of our embargoes of unfriendly nations. The Commerce Department on the other hand is charged with controlling all exports, reviewing and limiting those with incidental national security or foreign policy implications. Companies under Commerce jurisdiction are not dealing in arms or trading with "enemies", activities exporters could assume are regulated. Companies subject to the Export Administration Act are engaged in the kind of international, private commercial activity other parts of the Commerce Department are promoting and facilitating. Their expectations for procedural fairness are attendantly higher. This is one reason why Congress has imposed significant restrictions and directives on Commerce in its implementation of the EAA.

Because Commerce is examining private sector commercial transactions for incidental national security or foreign policy impact, the review process at Commerce is more complex. While there are policy determinations along the way, decisions regarding appropriate classification and suitability of the customer are heavily factual. Commerce is using its best judgment in all of these decisions, but those not purely policy need not be insulated from outside review.

The National Academy of Sciences' review of export controls concluded that all export regulations be consolidated into the Department of Commerce.[81] While this is an ambitious goal, and one with an uncertain political future, it emphasizes the need for careful review of the administrative procedures employed by Commerce and the need to incorporate traditional judicial review of the agency's administrative determinations.

## D. Judicial Review and Administrative Procedures Under the EAA

The Export Control Act of 1949 included no provision for any form of judicial review until it was amended in 1965.[82] The exemption in the statute from the Administrative Procedure Act eliminated any external procedures or review. In enforcement actions, criminal convictions were appealable through the traditional criminal judicial process, while denials of export privileges were considered part of Commerce's executive authority to control exports.[83]

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[81] NAS Study *supra* note 1 at 190-91.

[82] Export Control Act, Pub. L. No. 89-63, §F, 79 Stat. 209, 220-222 (1965).

In 1965 Congress gave the Commerce Department the authority to impose civil penalties. In conjunction with this Congress created the first avenue for judicial review under the act. Commerce had to sue the exporter in district court to collect the fine, and at that point all elements of the exporter's liability could be litigated *de novo*.[84] Congress also provided that the department could suspend export privileges for up to 1 year if the exporter refused to pay the fine.[85] No export control fine has ever been litigated through this process.[86]

In 1977 Congress added a new section to the EAA prohibiting United States companies from participating in foreign economic boycotts.[87] This was designed to blunt the impact of the Arab boycott of Israel on United States business. Congress was concerned that Commerce should follow strict procedures in finding violations of these rules because of the negative publicity that would attach to being identified as a participant in the Arab boycott.[88] So Congress required that hearings for violations of the antiboycott rules be held pursuant to the adjudication provisions of the Administrative Procedure Act.[89]

In 1979 Congress added a provision that permitted exporters to go to court if Commerce had not acted on export license applications within the statutory deadlines.[90] This was not judicial review, since all the court could do was to force Commerce to make a decision. Only one company has used this provision.[91] Commerce can easily say no if pressed to meet a time deadline, so this avenue of judicial intervention was never very promising.

In 1985 Congress told the Commerce Department that it had to use APA proceedings for its adjudications of violations of the export control provisions as well as the antiboycott provisions.[92] Since Commerce already had the procedures in place, the implementation of this change was relatively simple. The 1985 revision of the EAA also provided for appeals of license denials to an administrative law judge.[93] The grounds for appeal were very narrow, however,[94] and the ALJ decision was only a recommendation to the assistant secretary in charge of the program.[95] As with earlier procedural reforms, this one has never been used.

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[83] *See* Senate Comm. on Banking and Currency, Rep. on Export Control Act of 1949, No. 31 81st Cong., 1st Sess. 6 (1949).

[84] Export Control Act, Pub. L. No. 89-63, §F, 79 Stat. 209, 220-222 (1965).

[85] 50 U.S.C.A. app. §2410(d) (West Supp. 1990).

[86] It was not until 1981 when Core Laboratories, Inc. was found in violation of the 1977 antiboycott provisions of the EAA and refused to pay the fine that this provision was ever used. *See* notes 199-207 and accompanying text.

[87] 50 U.S.C.A. app. §2407(a) (West Supp. 1990).

[88] Senate Comm. on Banking, Housing and Urban Affairs, Report to Accompany S. 69 Export Administration Amendments of 1977, No. 104, 95th Cong., 1st Sess. 22 (1977).

[89] *Id.* 50 U.S.C. app. §2410 (c)(2)(B) (1990).

[90] Export Administration Act of 1979, Pub. L. No. 96-72, §10(j)(3), 93 Stat. 503, 503-536 (1979).

[91] *Daedalus Enterprises, Inc. v. Baldrige*, 563 F.Supp. 1345 (D.D.C. 1983). While the company obtained an order instructing the Commercial Department to make a decision, the Department denied the license. See Hunt & Breed *Export Administration Act: Penalties and Enforcement Process* in Coping with United States Export Contracts 1990, *supra* note 8 at 386.

The 1988 amendments to the EAA were a breakthrough in the area of judicial review. Congress made Commerce Department decisions to deny export privileges reviewable by the Court of Appeals for the District of Columbia Circuit.[96] This included decisions to deny privileges temporarily because a violation is imminent, and denials imposed after hearings for violations already committed.[97] This reform, coupled with the 1985 requirement for APA procedures in export control violation actions, brought enforcement of most of the law into conformity with contemporary standards of administrative due process. There is much left to be done however, and that is the focus of this report.

# III. Commerce Department Administration of the Export Administration Act

## A. The Threshold Policy Determinations: Which Countries, What Products

To effectively illuminate the nature and extent of the discretion exercised by the Commerce Department in administering the export controls system, a somewhat detailed description of the operation of that system is necessary. At the outset, the system of national security and foreign policy controls is premised on two quintessentially policy determinations, those countries that are the targets of controls and those products which must be controlled. The original impetus for the current system, the short supply controls of World War II and the immediate post-war era, involved decisions less obviously tied to the executive's exercise of military or foreign affairs powers and more plainly based on factual determinations.[98] With the shift to the national security and foreign policy basis, however, the decisionmaking process over the targets of controls and items to be controlled became more consultative with United States allies and cloaked in confidentiality.

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[92] Export Administration Amendments Act of 1985, Pub. L. No. 96-72, §114, 99 Stat. 120, 120-162 (1985).

[93] *Id.* §114(e).

[94] *Id.*

[95] *Id.*

[96] Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, §13(c), 102 Stat. 1325, 1325-1372 (1988).

[97] *Id.* §13(d)(1).

The EAA spells out criteria for the President to apply in determining to place a foreign nation on the list of countries subject to national security export controls.[99] This decision is usually made in conjunction with the other members of CoCom.[100] The reassessment of the status of the nations of Eastern Europe is an excellent example of the effort made by the CoCom countries to coordinate determinations of controls targets,[101] although those nations' inability to reach a consensus on aspects of decontrol shows the difficulty of achieving such coordination.[102] The multilateral characteristic of these decisions has been virtually guaranteed by the post World War II definition of national security in terms of two opposing blocs. As advances in technology spread more evenly throughout the West, the incentive of the Western nations to coordinate their efforts became quite strong. While that security incentive is dissolving today, competitiveness concerns will probably assure the orderly, collective decontrol of nations (as well as technology) to prevent one nation from securing a market advantage over the other participating states. In any event, the determination by the President of the United States of which countries are to be the target of national security export controls under the EAA will remain securely within the exclusive purview of his foreign affairs authority.

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[98] *See* Berman and Garson, *supra* note 33 at 795-96. The authors suggest that even at that point the primary purpose of the regulations was to restrict exports for national security reasons.

[99] Export Administration Act of 1979, Pub. L. No. 96-72, §5(3)(b), 93 Stat. 503, 503-536 (1979).

[100] The members of CoCom are: Australia, Belgium, Canada, Denmark, France, Germany, Greece, Italy, Japan, Luxembourg, the Netherlands, Norway, Portugal, Spain, Turkey, the United Kingdom, and the United States. The organization is relatively informal with a very small staff operation located in Paris. For background and history on CoCom, see Hunt, *Multilateral Cooperation in Export Controls - the Role of CoCom* 14 TOLEDO L. REV. 1236 (1983).

[101] *CoCom agrees to Rewrite Export Rules 'From Scratch,' United States Officials Report*, INT'L TRADE REP. (BNA) VOl. 7, No. 24, at 635 (June 13, 1990).

[102] *United States, CoCom Allies Continue to Disagree Over Easing Controls on Computer Exports*, INT'L TRADE REP. (BNA) Vol. 8 No. 12 at 424 (Mar. 20, 1991).

Designation of countries subject to foreign policy controls under the EAA has been more tightly restricted by the Congress,[103] and while this does little to change the discretionary nature of the decision, its reviewability by the courts may be enhanced. The President is obligated to consult with Congress before the imposition of controls[104] and strongly urged to consult with private industry as well about the effects and implications of such controls.[105] The EAA spells out detailed procedures for reports to the Congress and expiration and renewal of the controls.[106] While Congress has forcefully injected itself into the foreign policy controls determination process, the questions this raises relate to separation of powers issues rather than procedural due process protections for exporters affected by these controls.[107] However, judicial review might be available for the purpose of determining the consistency of Commerce designations with legislative intent.[108]

The second threshold determination necessary to the export control system is the nature of products subject to controls, the establishment of the Commodity Control List (CCL). This decision has a significantly more direct impact on individual exporters, but is still one fundamentally grounded in the military or foreign affairs authority of the President. At this juncture it is important to note an essential dichotomy in the controlled products determination. The policy decision here involves establishing the nature and level of technology to be controlled. This decision is reflected in a technological definition or standard used to measure specific products to determine if they are properly classified in the restricted category.[109] The individual exporter and the Commerce Department decide if a particular product is controlled or not based on its classification. The decision about the makeup of the CCL (i.e., what level of technology must be restricted for national security reasons), involves difficult policy judgments based in large part on sensitive national security intelligence. This decision, like that of which countries to target, falls within the discretionary foreign affairs authority of the President. The decision about whether a given product falls within or without a particular category, however, is largely a factual determination not dissimilar from Customs classification procedures.[110]

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[103] Export Administration Act of 1979, Pub. L. No. 96-72, 93 Stat. 503, 503-536 (1979), codified at 50 U.S.C.A app. §2405 (West Supp. 1990).

[104] 50 U.S.C.A app. §2405(f) (West Supp. 1990).

[105] *Id.*

[106] *Id.*

[107] *See* Carter, International Economic Sanctions: Improving the haphazard United States legal regime, 213-15 (1988). Congressional authority over regulating foreign commerce is quite clear, but where foreign trade and foreign policy intersect, tension with the President's claim of authority exists, *see Dames & Moore v. Regan* 453 United States 654 (1981).

[108] The 1990 Conference Report on the extension of the EAA (pocket-vetoed by President Bush) provided for judicial review of Commerce actions, but only where they were contrary to express provisions of the statute. One United States court of appeals has already entertained an *ultra vires* challenge to the secretary's action under the EAA, although not in the foreign policy context. In *Dart v. United States*, 848 F.2d 217 (D.C. Cir. 1988) the court found that the Secretary acted inconsistently with the requirements of the EAA in imposing civil sanctions, notwithstanding the EAA language on the finality of the Secretary's decision. Arguably judicial review of a Commerce determination under foreign policy controls is currently available for the purpose of determining consistency with Congressional directions. Congress appears to be interested in seeing that the Commerce Department is subject to judicial review at least when the agency acts contrary to explicit Congressional statements.

The Commerce Department has made substantial efforts to include the views of the private sector in formulating the technological standards. Congress established Technical Advisory Committees (TACs) to advise the department on technical questions relating to different areas of controls.[111] Ten

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[109] *See* Malloy, *supra* note 32 at 255-64. For example, the Commodity Control List entry for ECCN (Export Commodity Control Number) 1388A reads:

> 1388A Specially designed equipment for the deposition, processing and in-process control of inorganic overlays, coatings and surface modifications, for nonelectronic substrates by processes defined in the Table in Supplement No. 4 to Part 779 and specially designed automated handling, positioning, manipulation and control components, and "specially designed software" therefor.

Export Administration Bulletin No. 266 (June 1990). The entry goes on to list more specific types of products that fall within the described category. The first item on the (a) - (g) list is:

> (a) "Stored program controlled" chemical vapor deposition" (CVD) production equipment with both of the following:
>
> (1) Process modified for one of the following:
>
> (i) Pulsating DVD;
>
> (ii) Controlled nucleation thermal decomposition (CNTD); or
>
> (iii) Plasma enhanced or plasma assisted CVD; and
>
> (2) Any of the following:
>
> (i) Incorporating high vacuum (Less than or equal to 10-7 atm) rotating seals;
>
> (ii) Operating at reduced pressure (less than 1 atm); or
>
> (iii) Incorporating in situ coating thickness control;

[110] The recently enacted Harmonized Tariff schedule (replacing the TSUS listings) is much more extensive than the Commodity Control List because it attempts to create categories for every conceivable commodity. *See* Harmonized Tariff Schedule of the United States (1989). The difficulties associated with placing a specific product in a generally described category are the same, although the CCL classification process probably relies more heavily on the use of the item. *See generally* Harmonized Tariff Schedule of the United States, General Rules of Interpretations (1989); *see also*, Feller, *An Introduction to Tariff Classification* 8 LAW & POL'Y INT'L BUS. 991 (1976).

[111] 50 U.S.C.A. app. §2404(h) (West Supp. 1990). The role of the TACs was expanded by the 1988 Omnibus Trade and Competitiveness Act, Pub. L. No. 100-418, §2420(a), 102 Stat.

TACs are currently in operation.[112] Industry experts from the TACs may participate as members of the United States delegation to CoCom meetings to formulate the multilateral commodity lists that serve as the basis for the United States CCL.[113] Commerce also publishes requests for proposals to make changes in the CCL in the Federal Register. These efforts may become somewhat reduced with the recent efforts to develop a "core list" of controlled technologies for all CoCom and cooperating nations,[114] although they would still assist the United States in developing a position to take to CoCom. Ultimately, however, both the establishment of the United States position and final list developed multilaterally will remain outside the purview of United States courts.

The restriction of items on the CCL under foreign policy controls is even more a purely policy decision. While these controls utilize the categories of national security controls, the varied purposes and targets for foreign policy controls involve a wider range of goods and more diverse criteria in extending them.[115] The EAA provides that such controls should be, to the extent possible, used in conjunction with other nations,[116] but there is often less agreement on the use of such controls among the Western allies.[117] Regardless, the process for determining the controls to be applied against other nations for foreign policy reasons offers little room for challenge by affected exporters, except for consistency with statutory mandates.

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1107, to include consultation on mandated decontrol and, for the first time, on the promulgation of regulations.

[112] The Technical Advisory Committees are: (1) Automated Manufacturing Equipment; (2) Biotechnology; (3) Computer Peripherals, Components, and Related Test Equipment; (4) Computer Systems; (5) Electronic Instrumentation; (6) Materials; (7) Military Critical Technologies List Implementation; (8) Semiconductor; (9) Telecommunications Equipment; (10) Transportation and Related Equipment. For a discussion of the responsibilities and activities of the TAC's, *see* Bureau of Export Administration, Export Administration Annual Report 1989, 8-12 (hereinafter BXA Annual Report 1989).

[113] Hoydish, *The CoCom List Review Process* in Coping with United States Export Controls 1990, *supra* note 8 at 102.

[114] *See* Lavin, *The Core List*, in Coping with United States Export Controls 1991, *supra* note 2 at 87-96.

[115] 50 U.S.C.A. app. §2405 (West Supp. 1990). The full range of exports are subject to these restrictions, not merely dual use or high technology. *See* Carter, *supra* note 53 at 64-80.

[116] 50 U.S.C.A. app. §2403(b) (West Supp. 1990).

[117] *See*, Moyer & Mabry, *Export Controls as Instruments of Foreign Policy: The History, Legal Issues, and Policy Lessons of Three Recent Cases*, 15 LAW & POL'Y in INT'L BUS. 91, 158-61 (1983).

## B. Applying for the License: Classifying the Product

Because the vast majority of exports from the United States are made pursuant to the general license under Export Administration Regulations (EAR), the first phase of an exporter's obligation under the EAA is determining if specific permission in the form of an individual validated license is required. This process begins with checking the Commodity Control List contained in the EAR.[118] Each category of product subject to controls is described in technical terms and designated by a classification number, referred to as an Export Commodity Control Number, or ECCN.[119] The entry includes the type of controls the item is subject to, the countries to which exports of the item are controlled, and other pertinent data.[120] The exporter has to find the category on the list that most closely describes the product she wishes to export. The classification can then be used to check whether there are controls in place for the country of destination. Because the system is driven by these classifications, accurately pigeonholing the product becomes all-important. Because the potential universe of products is both extraordinarily fluid and virtually infinite, placing products in the correct category can be quite problematic.

Within the Bureau of Export Administration, the Office of Technology Policy Assessment (OTPA) has primary responsibility for assigning ECCN's. That office's Technology Analysis Division consists of four technologically specialized branches responsible for, among other things, maintaining and updating the CCL.[121] An exporter who is uncertain about a product's classification may request a classification designation from OTPA, which request will be assigned to the appropriate technical branch. The office has eliminated telephone consultations about classifications because of the huge potential for misunderstanding very technical descriptions and the problems of inappropriate reliance by exporters.[122] (Undoubtedly, because of the relatively small number of active practitioners dealing with export control questions, and their familiarity with OTPA staff, there is still significant telephone contact about classifications outside the formal request filing. This access of knowledgeable insiders is endemic to the administration of the EAA.) In filing the written request, the exporter must make her best effort to determine the classification, then submit the request for verification or correction to OTPA along with an explanation of the reasons for the classification and any technical information or literature about the product that will enable Commerce officials to make a classification determination.[123] Under the regulations, OTPA has 10 working days to respond to the request.[124] If the information is inadequate, and OTPA must request additional data, the time limit does not apply. In practice, the exporter desiring the least restrictive classification will not press OTPA on the time limit so long as she thinks the desired classification might be forthcoming. When OTPA does issue a classification determination, it carries no explanation, simply the ECCN the office has assigned and the name and telephone number of the technical staff member making the decision.

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[118] 50 U.S.C.A. app. §2403(b) (West Supp. 1990).

[119] 15 CFR §770.2 (1990).

[120] 15 CFR §770.1 (4) (1990).

[121] The branches are: (1) Electronic Components and Instrumentation Technology; (2) Computer Systems Technology; (3) Telecommunications Technology; (4) Capital Goods and Production Technology. For a general description of the functions of OTPA, see Export Administration Annual Report 1989, *supra* note 112 at 3.

[122] Berlack, *The Applicants' View of the Licensing Process* in Coping With Export Controls 1990, *supra* note 8 at 118.

In practice, the determination of the classification by OTPA usually involves informal contacts between the OTPA commodity specialist and the exporter's legal and technical staff. The situation is not adversarial in structure, but often the two sides are at cross purposes because of the exporter's interest in the least restrictive classification. There is often informal discussion up through the supervisory levels within the office. Should the exporter ultimately disagree with a final classification decision by OTPA, Part 789 of the Export Administration Regulations provides for the appeal of any adverse administrative action to the Assistant Secretary.[125] Over the past 3 to 4 years OTPA staff could only recall one such appeal being taken from a classification decision.

The vast majority of license applications filed by exporters do not have ECCN's determined by OTPA, but are classified by the exporter herself. Even where OTPA has assigned the commodity number, when the export license application is filed with the Office of Export Licensing (OEL) and referred to one of the technical branches in that office's Individual Licensing Division, the very first step of the review process includes verification of the ECCN. Disagreement between the technical staff of OTPA and OEL about how a product should be classified is not unheard of, although it usually involves circumstances where OEL believes the applicant provided inaccurate or incomplete information to OTPA as a basis for the decision.[126] Because these offices have very different functions, and also because OTPA provides the technical staffing to the Assistant Secretary of appeals from OEL licensing decisions (and for historic, bureaucratic reasons), there is limited formal communication between the technical staffs, even those dealing with the same technology. While informal contacts exist, apparently even they are not extensive. When differences arise between the two offices on questions of classification, the exporter will seek to have BXA adopt the least restrictive classification through informal discussions up through the management chain. This type of informal approach may well reach the assistant secretary level if the commodity is a sensitive one.[127] Because the only formal route to appeal an adverse decision on a classification question like this is also to the assistant secretary, the lack of formal appeals on these issues is readily understandable.

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[123] *Id.* at 119.

[124] 15 CFR §799.1(f)(1990).

[125] 15 CFR §789.2(a)(1990).

[126] Differences between the two offices were acknowledged by both those inside and outside BXA.

There is no public record of any kind of the classification decisions by the Commerce Department, just as there is no written explanation for these decisions provided to the exporter. Neither is there a formal internal system for tracking, maintaining, or sharing classification decisions. One OTPA official indicated that providing written explanations of classification decisions would probably require a tripling of staff under current workloads. Active exporters or those who use experienced representatives have access to their privately developed records of classifications decisions. This absence of a public reference point for exporters further enhances the "insiders" advantage.

With the changes already underway in reducing the types and ranges of technology subject to controls, the volume of classification questions will shrink while their significance grows.[128] The articulated objective of the United States and other members of CoCom is to become more restrictive with regard to fewer products.[129] The decision about which side of the wall the export commodity is on will be critical. Demands by exporters for recourse to external relief from adverse decisions in some form will grow with the impact of these decisions.

## C. Applying for the License: Other Critical Designations

Once an exporter determines that her product falls into a controlled category, by checking the country restrictions and other notations by the ECCN entry, she will know if a validated export license is required. She then files an application for a license, providing the Office of Export Licensing all of the requisite information. The most critical of this information includes the country of destination, the identity of the intermediate and ultimate consignees, the ultimate end-user of the product, and the destined specific end-use. These three categories, the country, the parties, and the use, provide the basis for OEL's review of the application and their exercise of discretion in granting or denying a license. Two of these elements, the country and end-use, also provide the basis for the decisions of the other agencies that may review the application, and for the decision of the foreign nation members of CoCom who may also have to review the application.

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[127] The office directors of the respective offices report to the Assistant Secretary. If there is a fundamental disagreement, the matter will likely reach that level as the exporter seeks resolution.

[128] With fewer controlled categories, the impetus to classify in the most restrictive way may increase out of the agency's normal cautiousness.

[129] *United States to Submit Proposal for 'Core List' of Controlled Items to CoCom this week*, INT'L TRADE REP. (BNA) Vol. 7 No. 38 at 1470-71 (Sept. 26, 1990).

Prior to substantive review of any of the categories, OEL reviews the license applications to make certain that all of the blanks are filled in, requisite supplemental material provided (or whether OEL will request such material since much of it no longer has to be filed with the application[130]), and everything properly signed. An incorrect ECCN based on what OEL believed was an erroneous classification would also be flagged at this stage. Applications with these types of problems are returned without action (RWA) by OEL. During fiscal year 1989 OEL returned 5,692 applications without action out of 85,215 processed.[131] The RWA letters indicate the nature of the deficiency. BXA has stated that every exporter receiving an RWA letter has been informally advised of the problem prior to the issuance of the letter.[132] Additional follow-up with the licensing officer is possible to clarify the problem.

The three primary areas of substantive review, the country, the parties, and the end-use involve very different mixtures of factual and policy based evaluation. Concerns about the country of destination are probably the most policy-based but still have heavy factual components. Concerns about the parties and end-use are heavily fact-oriented, although they still involve some policy judgments. More problematic for the fact-oriented concerns is that much of the factual material OEL is using to make its determinations is confidential in nature, some of it subject to extremely high level national security classification.

Shifting concerns about the behavior and policies of individual countries have a direct impact on the approval of licenses by OEL. There are obvious official changes in the status of countries that exporters can discover through published notices,[133] but the more subtle shifts, or those that occur in advance of published changes, may be harder to divine or understand. When the Chinese government imposed harsh measures against the demonstrators at Tianemen Square, there was both a shift in licensing policy at OEL and a drop-off in license applications by exporters prior to any official response by United States officials. Most shifts are not so high profile, however. OEL licensing officers receive notice of changes in policy, but such notices are not public information. Nor are these notices specific with regard to products, although they may be more so with regard to categories. Licensing officers have responsibility for interpreting and applying policy decisions made about countries. License applications rejected because of unpublished policy biases against a particular nation will include no meaningful explanation in the rejection notice and are thus difficult to appeal either formally or informally.[134]

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[130] 15 CFR §770.13(b) (1990).

[131] Export Administration Annual Report 1989, *supra* note 112 at 15.

[132] *Id.*

[133] *See*, *inter alia* Executive orders prohibiting transactions with Iraq and Kuwait, Exec. Orders No. 12772, No. 12723 26 Weekly Comp. Pres. Doc. 1182-89, Aug. 2, 1990.

Another basis for rejecting a license because of the country of destination is the concern that the country has an official or unofficial predisposition towards diverting goods to other nations that are restricted. The basis for this concern may well be national security classified information relating to the policies of the country, the effectiveness of its export control system (including the competency and/or corruptibility of the personnel), and similarly sensitive matters. The information may have come to Commerce from such sources as the State Department, Defense Department, National Security Agency, or Central Intelligence Agency. It may be so highly classified that the licensing officers are not provided with any reason for notice of a restriction, but simply given the restriction itself. Obviously the nature of a notice of a license application rejection based on this kind of information is going to be very summary. In fact, it is unlikely that the notice will differ at all from that provided for a decision based on an unpublished policy concern as discussed above.

The same sources of information will provide a partial basis for pre-license checks of foreign consignees and end-users. This part of the application review may involve reference to the "gray-list" maintained by BXA of foreign parties who are under some cloud, or if the firm is new or unknown, it will involve some more active investigation by the Office of Export Intelligence or Office of Export Enforcement.[135] In 1989, 238 license applications were denied or returned without action (RWA) based on information known to BXA. Another 125 were denied or RWA'ed after OEI or OEE conducted pre-license investigations of end-users or consignees.[136] Names of firms on the gray-list come from a variety of intelligence sources, and BXA may have no information about the basis for a firm's listing. The list, and the sources and details behind the entries, are subject to national security classifications that may range to the highest levels. Denial of an application for a suspicious end-user or consignee can be a frustrating experience for an exporter. While she will be told that there is a problem with one of her foreign parties, no details will be provided. Formal or informal discussions with BXA can be futile especially where Commerce has no access to the information that placed the foreign company on the list in the first place. While BXA officials will entertain appeals of denials based on suspect foreign parties, they will only accept information from the applicant designed to demonstrate the trustworthiness of the foreign party. BXA will not respond with any details about the basis for the suspicions, so the exporter must try to anticipate what may be the problem and address it.

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[134] While Commerce officials maintain they provide actual notice orally to affected exporters, it is hard to appeal from a decision provided by telephone at the staff level. *See* Recommendation D.I. *infra*.

[135] Export Administration Annual Report 1989, *supra* note 112 at 4-5, 80-81.

[136] *Id.* at 80.

Factual concerns about the ultimate end-use of a product present a somewhat different dilemma for the exporter. While classified national security information may play some role, denials for end-use reasons more frequently involve differences between the exporter and BXA or Defense Department officials in technical judgments about an item's technical capacities or limitations.

The new restrictions on commodities that could be used for chemical or biological weapons on missile technology will exacerbate this problem.[137] Because the primary concern of the national security controls is the dual civilian and military uses of controlled items, the government examines goods from the perspective of how they might be put to military uses. Exporters marketing to civilian enterprises have no real reason to think in terms of potential military uses. The potential diversion of an item from civilian to military use involves questions about both the country and the end-user more than the use, but BXA often will identify a potential application for an item that it believes renders it too big a risk regardless of the bona fides of the end-user. The exporter may disagree that her equipment is capable of the application BXA has identified. Or the exporter may argue that the equipment has been modified is such a way as to preclude the suspect application. While these disputes may involve classified information BXA has about the state of military technology in the end-user's country, they more frequently involve disputes about the capability of the exporter's product. Although the exporter has an interest in understating equipment capabilities in order to get a license, she also has much greater knowledge of the capabilities of the equipment. In an informal or formal appeal of license denials based on potential end use, the exporter and BXA stand on somewhat more equal footing with regard to access to the relevant information than they do for rejections based on country policies or suspect end-users. Since the ultimate decision is the Commerce Department's, however, the exporter is still vastly overmatched.

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[137] *See* note 2 *supra*.

## D. Referral of Applications to Other Agencies

While the Commerce Department is the central agency for the export controls applied to civilian goods, the Bureau of Export Administration does not have sole responsibility for all export license applications. The Departments of State, Defense, and Energy have key roles in the process.[138] The nature and extent of their involvement, particularly that of the Pentagon's Defense Technology Security Administration (DTSA), have been the focus of significant discussion and recent legislative action.[139] In theory, when Commerce refers an application to another agency for review, the agency must respond within 40 days or Commerce is free to act on its decision.[140] There is a formal mechanism for resolving disagreements between the agencies over license applications that ultimately reaches to the President.[141] Neither the time limits nor the resolution process work as smoothly as designed. The interagency process was revised somewhat by executive order in December 1990[142] but exporters will continue to have serious difficulties in the interagency review process.

Two significant problems involve notice to the exporter of when a license was referred, and whether or not all of the relevant information provided by the exporter to BXA has been provided to the other agency. Complaints about delays and the routine disregard of the 40-day deadline are common. The other agencies may not start counting days until they decide they have all of the information they need to make a decision. The exporter may not know when the initial referral to another agency took place, let alone when that agency decided the file was complete and the clock should start to run. Similarly, the exporter will not know what information BXA has sent to the other agency and may not know how best to deal with problems perceived by that agency.

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[138] *See*, Note, *Failures in the Interagency Administration of National Security Export Controls*, 19 LAW & POL'Y IN INT'L BUS. 337, 549 (1987)

[139] 50 U.S.C.A app. §2409(g) (West Supp. 1990). *See Berlack, The Applicant's View of the Licensing Process* in Coping With United States Export Controls 1990, *supra* note 8 at 138-41 (1990).

[140] 15 CFR §770.13(e) (1990).

[141] 50 U.S.C.A app. §2409(g) (West Supp. 1990).

[142] *See White House Fact Sheet on Export Controls Procedures*, December 13, 1990, reprinted in Coping with United States Export Controls 1991, *supra* note 2 at 605.

The reviews conducted by the other agencies are more specialized or focused reviews of the same elements considered by Commerce. DTSA is concerned about the potential uses of the equipment[143] while the Office of East/West Trade at the State Department has country policy concerns.[144] Where there is disagreement among the agencies, Commerce will usually be in favor of granting the license and use its technical people to argue for the license. The exporter is not a party to any of this, although she will probably be working informally with BXA staff at some point to make the strongest case for the license. A license application denied as a result of an objection by another agency will not reflect that in the denial notification, nor will details of the basis for the rejection be provided.[145]

## E. Referral of Applications to CoCom

Some especially sensitive license applications must also be reviewed by the other countries that make up CoCom.[146] The number of these licenses is dramatically declining with the changes in Eastern Europe. Objections raised by other CoCom members tend to be heavily policy oriented and if acceded to by the United States represent foreign policy decisions of a very high order.[147]

## F. Special Licensing Procedures

There are five different types of special licenses OEL issues to exporters, designed primarily to permit repeated shipments to the same end user of similar goods.[148] The two most common are the project licenses[149] and the distribution licenses.[150] The project license is commonly issued for off-shore construction projects by United States companies involving a wide array of United States source material and by foreign-based airlines for operating supplies.[151] The distribution license is the most common special license and the one that raises the most procedural questions. Distribution licenses permit exporters to make multiple shipments of controlled goods to a wide range of pre-approved end-users without securing an individual license for each shipment. The applicant for the license must demonstrate a sophisticated knowledge of the export control system and have in place a compliance program that will effectively prevent abuses such as diversion of the goods or their unauthorized re-export.[152]

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[143] *See* Hamilton, *The Defense Technology Security Administration* in Coping With United States Export Controls 1990, *supra* note 8 at 341, 350-52 (1990).

[144] *See*, Berlack, *The Applicant's View of the Licensing Process* in Coping With United States Export Controls 1990, *supra* note 8 at 139.

[145] *Id.* 137.

[146] 15 CFR §770.14 (1990).

[147] These objections are also somewhat unusual since the United States is the most conservative vote in CoCom, *see e.g. United States, CoCom Allies Continue to Disagree over Easing Controls on Computer Exports*, INT'L TRADE REP. (BNA) Vol. 8, No. 12 at 424 (Mar. 20, 1991).

[148] 15 CFR §773 (1990).

[149] 15 CFR §773.2 (1990).

Because the Commerce Department is delegating some of its control responsibility to the licensee under the distribution license, OEL is required to conduct periodic reviews of the effectiveness of licensees' internal control programs.[153] The Department can summarily suspend the distribution license if officials determine that the exporter has not met her obligations for policing the shipments.[154] The effect of the suspension is to compel the exporter to secure an individual validated license for each export. During fiscal 1989 OEL suspended seven distribution licenses.[155] Between 1985 and 1989 a total of 41 such licenses were suspended.[156] While this decision would constitute an adverse agency action under Section 789 of the regulations and would thus, like all other such actions, be appealable to the Assistant Secretary, his decision is final. OEL handles the review, approval, supervision and suspension of distribution licenses out of one branch, which consequently exercises substantial authority.

## G. Foreign Availability Determinations

A common complaint of critics of the United States system of export controls has been that it is anticompetitive.[157] This complaint carries less weight when directed towards foreign policy controls because the United States is consciously deciding to forego trade to make a diplomatic point.[158] With regard to national security controls, however, the criticism is very pertinent. The premise of national security controls is to prevent target nations from acquiring goods and technology that could advance their capabilities at the expense of United States security. Critics have argued that the United States imposes controls on United States goods that are freely available from other, noncontrolled sources, thus depriving the United States of markets without any salutary effect on national security. The foreign availability provisions of the Export Administration Act adopted in 1979 were supposed to address this problem by creating an exception that requires decontrol of an otherwise prohibited export if the equivalent product is available from uncontrolled sources.[159] The Office of Foreign Availability within the Bureau of Export Administration is responsible for determining if, in fact, the product is available. The process is most often triggered by formal or informal demands of exporters, including exporters who have had licenses denied and who maintain that the same item is available outside the United States free from controls.

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[150] 15 CFR §773.3 (1990).

[151] 15 CFR §773.8 (1990).

[152] *See* Albanese, *The Distribution License Program* in Coping With United States Export Controls 1990, *supra* note 8 at 219, 228-30.

[153] *Id.*

[154] 15 CFR §773.1(f) (1990).

[155] Export Administration Annual Report 1989, *supra* note 112 at 19.

[156] *Id.* at 23.

[157] *See inter alia Reauthorization of the Export Administration Act: Hearings on 5.397, 5.407, 5.434 and 5.979 Before the Subcommittee on International Finance and Monetary Policy*

The foreign availability determination is an almost purely factual one. The office has to ascertain four things: (1) Is there a non-United States source for the product? (2) Is the foreign product of truly comparable quality? (3) Is it available in sufficient quantity to satisfy the controlled country demand? and (4) Is the product available-in-fact to the controlled country, i.e., will the vendor and source country really permit the product to be sold to the controlled country customer?[160] Much of this information is available from commercial sources and is provided by the exporter seeking to demonstrate that her foreign competitors are marketing without restriction. The Office of Foreign Availability relies on other sources of information, however, including the Departments of State and Defense, the intelligence agencies, and

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*of the Senate Comm. on Banking, Housing, and Urban Affairs*, (statement of Arthur T. Downey representing the United States Chamber of Commerce); *United States Chamber of Commerce Sharply Critical of Administration's Export Control Scheme*, INT'L TRADE REP. (BNA) Vol. 7, No. 20 at 684-85 (May 16, 1990).

[158] *But see*, Interim and Proposed Rules or Expansion of Foreign Policy Controls on Equipment and Technical Data Related to Chemical and Biological Weapons 56 Fed Reg. 10,760 (March 13, 1991). These controls are designed to restrict the proliferation of these weapons. The Bush administration is apparently committed to the controls even if other nations do not cooperate. *See United States Announces New Controls on Exports of CBW-Related Goods, Missile Technology*, INT'L TRADE REP. Vol. 8, No. 11 (Mar. 13, 1991) at 376-77.

[159] 50 U.S.C.A. app. §2404(f) (West Supp. 1990).

[160] *Id.*

the Commerce Department's United States and Foreign Commercial Service officers.[161]

Two key points of tension in the foreign availability determination involve judgments about the comparable quality of the foreign product, and whether the quantity is sufficient for the needs of the controlled country customer. These issues are similar to disagreements about the potential end use of the product discussed above,[162] where the Department of Defense or one of the intelligence agencies may claim to have information about the actual uses of the product or needs of the customer based on classified information that negate the apparent comparable quality or sufficient quantity. Once Commerce has made a preliminary determination of foreign availability, the decision is circulated to the other agencies concerned with the national security control process for review and comment. They may offer additional evidence on the elements of the determination. Congress has described the different burdens of proof for establishing foreign availability ("reasonable" evidence of the four elements)[163] and for refuting this finding ("reliable" evidence).[164] The final determination, however, is left with the Secretary of Commerce (delegated to the Assistant Secretary for Export Administration), leaving to staff the collection and weighing of the evidence. The Section 789 procedure for appealing an adverse decision would apply to these findings as to any other functions carried out by BXA under the EAA, with the already noted limitations of this process. A positive finding of foreign availability by Commerce does not automatically mean that the product can be shipped to the controlled destination. If the item is controlled through CoCom, the decision must be referred there for 4 months to enable the other members to consider it and take whatever steps they wish to take.[165] More significantly, the President has the ability to suspend the decontrol effects of the determination while he attempts to negotiate controls with the country that has the product available. While these efforts can extend up to 18 months, if negotiated control is unsuccessful, the United States controls are lifted.[166]

The foreign availability of items the United States seeks to control for national security purposes has grown with the American loss of technological dominance in the world. While most other nations capable of producing high technology products are members of CoCom, differences in interpretation of the definitions embodied in the control list have resulted in arguments that equivalent CoCom produced goods are not controlled. Congress has been dissatisfied with Commerce's handling of the foreign availability determinations and has revisited the issue several times, most recently in the 1988 Omnibus Trade and Competitiveness Act.[167]

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[161] Export Administration Annual Report 1989, *supra* note 112 at 54.

[162] *See* note 137 *supra* and accompanying text.

[163] 50 U.S.C.A. app. §2404(f)(3) (West Supp. 1990)

[164] *Id.*

[165] *Id.*

[166] 50 U.S.C.A. app. §2404(f)(4) (West Supp. 1990).

The legislative changes have focused to a great extent on the administration of the process, defining standards, establishing deadlines, and clarifying Commerce's sole authority to make these decisions. Consistent with the other administrative decisions made by Commerce under the EAA, Congress has created no external review mechanism for adverse foreign availability decisions. While there are problems created by the classified nature of some of the information BXA may use in making foreign availability determinations,[168] the basic decision is in the nature of an application of a standard to a set of facts, a process subject to judicial review throughout the federal government. The policy issues arise when Commerce finds foreign availability and the President wishes to try to eliminate the foreign source's willingness to sell to a controlled country through negotiations. There appears to be little reason not to allow an exporter who loses the argument that foreign equivalent goods are available before the Commerce Department to have recourse to external appeal.

In August 1990 the Department of Commerce released the final version of its new rules for foreign availability determinations under the 1988 statutory revisions. These rules reflect a continuation of the department's orientation towards exporting as a privilege. The exporter bears the most substantial portion of the burden of demonstrating foreign availability, notwithstanding Commerce's acknowledgment of the superior position of the government to obtain the relevant information.[169] Commerce has wide latitude in what sources it may consult in making its determination; there is no provision for providing an explanation for its ultimate decision; and the only recourse from an adverse decision is the Section 789 procedure discussed below.[170] Major reforms to the export control system will require explicit legislative direction to overcome the patterns of regulation ingrained at Commerce.

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[167] Pub. L. No. 100-418, §2418(a), 102 Stat. 1107, (1988). Codified at 50 U.S.C.A. app. §2404(h) (West Supp. 1990). Congress required the President to keep Congressional Committees informed about his efforts to eliminate the foreign source, and made a series of liberalizing procedural changes aimed at making it easier for an exporter to demonstrate foreign availability.

[168] "An important participant in the foreign availability assessment process is the intelligence community. Daily Review of intelligence data is an integral part of the foreign availability assessment process." Export Administration Annual Report 1989 *supra* note 112 at 55.

[169] 55 Fed. Reg. 32, 899 (1990), to be codified at 15 CFR part 791.

[170] *See infra* text accompanying notes 173-179.

## H. Appealing License Denials and Other Administrative Determinations

Section 789.2(a) of the Export Administration Regulations[171] states, "Any person directly and adversely affected by an administrative action. . . taken by the United States Department of Commerce may appeal to the Assistant Secretary for reconsideration of that administrative action."[172] Section 789.2(c)(2) provides that "[t]he decision of the Assistant Secretary shall be final."[173] These sections apply to the full range of nonenforcement decisions by the Bureau of Export Administration, including classifications, cancellations of distribution licenses, negative foreign availability determinations, and license denials. Section 12(e) of the Export Administration Act is entitled "Appeals From License Denials" and provides for review by an administrative law judge "who shall have the authority to conduct proceedings **to determine only whether the item sought to be exported is in fact on the control list.**" (emphasis added) The ALJ's determination is subject to review by the Secretary who can affirm or vacate.[174] Thus there are two apparent avenues to review of license denials. Such appeals to the assistant secretary[175] under the regulations are not uncommon, numbering around 50 during 1989 (out of 216 licenses denied[176]). Since the EAA statutory license appeal provision was adopted in 1985, however, not a single appeal has been taken.

Under the current arrangement there is little reason to appeal formally from a denial of an export license or any other adverse decision of BXA under the Section 789 procedures. Because there is significant opportunity for informal discussion at all levels within BXA, and because there is no recourse from either a formal or informal decision at the highest level of BXA, there is no incentive to use the formal mechanism. This aspect of the process places an extraordinary premium on familiarity with the internal procedures and personnel of the agency. While knowledgeable insiders have an advantage in any agency (and many courthouses for that matter), where the agency has been subject to virtually no outside scrutiny for over 40 years other than that of Congress, the problem is extreme. The absence of written decisions or justifications for agency actions deepens the advantage of familiar representatives able to tap into the informal institutional memory of the organization.

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[171] 15 CFR §789.2(a) (1990).

[172] *Id.*

[173] 15 CFR §789.2(c)(4) (1990).

[174] 50 U.S.C.A. app. §2412(e) (West Supp. 1990).

[175] 15 CFR 789.1 (a) defines the assistant secretary as the Assistant Secretary for Trade Administration. This position was eliminated when the export control area at the Commerce Department was reorganized in 1985. Export Administration Amendments of 1985, Pub. L. No. 99-64, Title I, §116(a), 99 Stat. 152. *See* Bureau of Export Administration, Export Administration Annual Report 1986, at 5. The new structure provided for two assistant secretaries, an Assistant Secretary for Export Administration and an Assistant Secretary for Export Enforcement. Appeals of export licensing decisions are made to the Assistant Secretary for Export Administration although the regulations have not been formally amended.

[176] Export Administration Annual Report 1989, *supra* note 112 at 14. The number of denials is somewhat misleading because 5,692 license applications were returned without action (RWA) due to some problem in the application. *Id.* The problem could be a substantive one that would lead to a denial if pursued. The Office of Export Licensing does not keep track of those RWA licenses that are withdrawn.

One of the procedural obstacles in this appeals process is the fact that there is virtually no written initial decision on which to base an appeal. The department's adverse decision in any matter is communicated in writing in only the most summary terms.[177] While there may be substantial informal, oral explanations communicated from BXA staff to the exporter about the eventual adverse decision, when it is formally issued it is conclusory only, with no discussion or explanation. This means that when an exporter presents an appeal she must set out the government's case as she understands it, and then attack it with her arguments. The staff of BXA is free, through virtually unrestrained opportunity for *ex parte* discussion,[178] to correct, modify or recharacterize the appellant's depiction of the staff decision, rendering the exporter's presentation anywhere from slightly off-point to wholly irrelevant.

A senior BXA official indicated that the primary reason he believed parties formally appealed license denials was to satisfy contractual obligations by triggering *force majeure* clauses. Some of the formal license appeals are more substantive than that, however, usually involving technical disputes about the use of the equipment. The assistant secretary relies on the technical staff in the Office of Technology and Policy Assessment to review *de novo* the license application. This process can provide a beneficial second look at a close technical decision. Denials based on country policy decisions or classified data about a suspect end-user provide little basis for another look by the agency, however. And any application raising truly significant issues of any kind will probably already have reached the assistant secretary before the initial decision.

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[177] A typical explanation of a denial will simply state that the end-user is unacceptable or that the export is inconsistent with national security.

[178] 15 CFR §789.2(c) (1989) provides in part: "the Assistant Secretary shall consider any recommendations, reports, or relevant documents available to the Department of Commerce in determining the appeal, but shall not be bound by any such recommendation, nor prevented from considering any other information, *or consulting with any other person or groups*, in making a determination." (emphasis added).

The statutory appeal process for license denials before the administrative law judge is extremely limited. The only issue that can be reviewed, whether or not an item is on the list, is the question of the proper classification under the Commodity Control List.[179] An exporter who disagrees with a classification decision could appeal to the assistant secretary under the regulatory appeal process. Appeal to the ALJ of this question would provide the advantage of a third party look at the classification, but the decision is subject to review by the Under Secretary for Export Administration, who would no doubt rely on the staff of BXA for advice. There appears to be little awareness or interest in this provision among those exporters and practitioners who regularly deal with BXA. Whether this is because there are few classification issues or because there is little confidence in the procedure as effective recourse for an adverse decision is not clear.

## IV. Commerce Department Enforcement Procedures

Enforcement of the export control provisions of the Export Administration Act is centered in the Office of Export Enforcement of the Bureau of Export Administration. Responsibility is shared, however, with the Customs Service, which has the responsibility for patrolling the nation's ports and screening exports,[180] and with elements of the Justice Department such as the FBI for criminal investigations.[181] There has been a significant amount of tension between Commerce and Customs in recent years over which agency has primary responsibility for investigation and enforcement, and Congress has attempted to define the boundaries.[182] Exports seized by Customs trigger Customs procedures and penalties relating to forfeiture of the goods.[183] Commerce remains responsible for prosecuting the EAA violations and imposing sanctions.

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[179] 50 U.S.C.A app. §2412(e) (West Supp. 1990). It is not clear what the practical dimensions of this review are since the provision has never been used. Presumably the only argument an exporter would have is that the item should be placed in a less restrictive category.

[180] *See* Hunt & Breed, *Export Administration Act: Penalties and Enforcement Process* in Coping with Export Controls 1990, *supra* note 8 at 370-371.

[181] *Id.* at 372, 386.

[182] Export Administration Amendments Act of 1985, Pub. L. No. 99-64, §113(a)(5), 99 Stat. 120, codified at 50 U.S.C.A. app. §2411(a)(2) (West Supp. 1990).

[183] *See* Basha, *Customs Export Enforcement* in Coping with Export Controls 1990, *supra* note 8 at 399-405.

## A. Criminal Enforcement

Because the act includes criminal penalties for violations, Commerce works closely with the Justice Department and local United States attorneys. There have been a significant number of criminal prosecutions for violations of the EAA, which are subject to the criminal judicial process.[184] The nonreviewability of certain administrative decisions at Commerce has an effect on what defendants can argue in criminal cases. Where defendants have sought to challenge the classification of a product on the commodity control lists, courts have deferred to the discretion of the secretary and declined to permit inquiry.[185] While Commerce must prove all of the elements of the criminal offense[186] the present judicial unreviewability of the classification and licensing decisions presents an obstacle in criminal cases to the defendant's ability to question the correctness of Commerce predicating decisions.

## B. Civil Enforcement

Civil enforcement actions are far more common and within the last 6 years Congress has moved the EAA civil enforcement procedures much closer to the standards of the Administrative Procedure Act. Since 1985, civil enforcement actions for export control violations must be brought before an administrative law judge in a hearing pursuant to sections 556 and 557 of the APA.[187] The ALJ makes a recommended decision and forwards it to the Under Secretary for Export Administration, who may affirm, modify, or vacate the order.[188] Since 1988 final Commerce enforcement judgments for export control violations, the decision of the Under Secretary, have been appealable to the United States Court of Appeals for the D.C. Circuit.[189] These changes were the result of many years of effort by concerned exporters and coincided with a D.C. Circuit decision that raised the first hint of judicial review of an enforcement decision.[190] One of the most controversial areas of Commerce Department enforcement of the EAA has been the use of temporary denial orders (TDO) to prevent persons from exporting from the United States. The procedures for this process were required to be reformed by amendments to the EAA in 1985.[191] When Commerce learns that a violation of the export control rules is imminent, the department may apply for a 180-day TDO against the suspected party from the Assistant Secretary for Export Enforcement.[192] This order can be issued on a wholly *ex parte* basis, as they frequently are.[193] Like other regulations providing for emergency administrative actions, the Commerce rules provide for a hearing following the issuance of the TDO. Unlike other programs, however, the hearing must be sought by the affected party in the form of an appeal of the TDO to an administrative law judge. At the hearing the affected party is entitled to challenge the finding that a violation of the EAA is imminent.[194] The decision of the ALJ is in the form of a recommendation to the Assistant Secretary for Export Enforcement, the official who granted the TDO initially.[195] The denial orders can be extended repeatedly on the basis that the danger of a violation is still imminent.[196] When judicial review of export enforcement actions was added with the 1988 amendments, judicial review was also provided for temporary denial orders.[197] According to Commerce, most TDOs are directed against foreign parties, and consequently little use is made of the administrative procedures.[198]

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[184] For fiscal years 1985-89 the Commerce Department imposed civil penalties in 138 cases, and assisted the Justice Department in obtaining 41 criminal convictions. During that period of time the Department also issued 30 temporary denial of export privileges orders. Data compiled from Export Administration Annual Reports, 1985-1989.

[185] *See* United States v. Spawr Optical Research, Inc., 864 F.2d 1467, 1473 (9th Cir. 1988); United States v. Mandel, 914 F.2d 1215, 1220-23 (9th Cir. 1990).

[186] United States v. Gregg, 829 F.2d 1430, 1435-36 (8th Cir. 1987).

[187] 50 U.S.C.A app. §2412(c)(1) (West Supp. 1990).

[188] *Id.*

[189] 50 U.S.C.A app. §2412(c)(3) (West Supp. 1990).

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[190] Dart v. United States, 848 F.2d 217 (D.C. Cir. 1988). In this case William Dart was charged by the Commerce Department with violating the export control provisions of the EAA, but the administrative law judge found that the department had failed to prove the charges. The assistant secretary reversed the ALJ decision and imposed a civil penalty against Dart. Dart sought review of the decision in federal district court, but the judge dismissed for lack of jurisdiction based on the language of the EAA that such decisions are final. Before the Court of Appeals, supported by an *amicus curiae* brief filed by the American Bar Association, Dart argued that the secretary exceeded his statutory authority to "affirm, modify or vacate" ALJ decisions by, in this case, reversing the decision. In an opinion analyzing the legislative history of the EAA preclusion of judicial review, the court found that it did have the authority to review actions of the secretary that were in excess of his legislative authority, and that this was such a case. The court reversed the district court and returned the matter to the Commerce Department for action consistent with opinion. This decision came out in May 1988. In August the EAA was amended to provide for judicial review of export control enforcement actions.

[191] Export Administration Amendments of 1985, Pub. L. No. 99-64, §§114(3)(d), 99 Stat. 129 (1985), codified at 50 U.S.C.A app. §2412(d) (West Supp. 1990). This enactment provided the first express statutory basis for temporary denial orders. *See* Hunt & Breed, *Export Administration Act: Penalties and Enforcement Process* in Coping with United States Export Controls 1990, *supra* note 8 at 382.

[192] 50 U.S.C.A app. §2412(d) (West Supp. 1990).

[193] *See* Hunt & Breed, *Export Administration Act: Penalties and Enforcement Process* in Coping with United States Export Controls 1990, *supra* note 8 at 383-84.

[194] 15 CFR §788.19(d)(2) (1990).

[195] 15 CFR §788.19(e)(4) (1990).

[196] 15 CFR §788.19(d)(3) (1990).

## C. Judicial Review

Notwithstanding the 1985 and 1988 legislative reforms, several anomalies in judicial review of EAA enforcement remain to be addressed. This report has only treated the export control provisions of the Export Administration Act to this point. Since 1965, the EAA has also been the vehicle for the United States law restricting the participation of Americans in the foreign boycotts or embargoes of other nations.[199] Commerce was required to collect reports from United States companies of requests they received to participate in unsanctioned foreign boycotts, the primary one being the Arab boycott of Israel. In response to the enhanced power of the Arab boycotting states following the oil price increases of the mid-1970s, these so-called "antiboycott" provisions of the EAA were substantially strengthened in 1977 to prohibit certain activities by United States firms in support of unsanctioned foreign boycotts. A separate Office of Antiboycott Compliance was created to enforce these provisions. While Congress incorporated the antiboycott prohibitions into the EAA and its set of civil and criminal sanctions, concerns were raised about the rather summary nature of enforcement procedures under the act. In response, the 1977 amendments required that hearings for violations of the antiboycott rules be conducted pursuant to sections 556 and 557 of the APA.[200] Commerce adopted regulations implementing this requirement, which became the basis for rules for all enforcement actions following the 1985 amendments.

While introducing APA standards for initial hearings, the 1977 antiboycott amendments added nothing to the judicial review process under the EAA. At that time the only means of judicial review of sanctions imposed under the act applied to monetary fines imposed for violations.[201] Denial of export privileges was not subject to any form of outside review. When a civil fine was imposed, however, the department had to bring an action for recovery of the fine in federal district court, where all elements establishing liability were subject to *de novo* consideration by the court.[202] Another provision of the EAA provided that payment of a civil fine could be made a condition for the "granting, restoration, or continuing validity of any export license, permission, or privilege granted" under the act.[203] With Commerce having this kind of leverage, it is no surprise that until a respondent in an antiboycott action refused to pay a fine in 1981, this avenue of judicial review had never been used.

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[197] 50 U.S.C.A app. §2412(d)(3) (West Supp. 1990).

[198] Hunt & Breed, *Export Administration Act: Penalties and Enforcement Process* in Coping with United States Export Controls 1990, *supra* note 8 at 384.

[199] 1965 Amendments to the Export Control Act of 1949, Pub. L. No. 89-63, 79 Stat. 209, codified at 50 U.S.C.A app. §§2401-2403 (West Supp. 1990). For a discussion of the development of the antiboycott provisions of the EAA see Fenton, *United States Antiboycott Laws: An Assessment of Their Impact Ten Years After Adoption*, 10 HASTINGS INT'L & COMP. L. REV. 211, 232-37 (1987).

[200] 1977 Export Administration Amendments, Pub. L. No. 95-52, Title II, 83 Stat. 846, codified at 50 U.S.C.A app. §2410(c)(2)(B) (West Supp. 1990). *See* Senate Comm. on Banking, Housing and Urban Affairs, Report to Accompany S.69 Export Administration Amendments of 1977, No. 104, 95th Cong., 1st Sess. 22 (1977).

When the *de novo* procedure was first used in *United States v. Core Laboratories*,[204] a question arose about the appropriate statute of limitations to apply. Core argued that the 5-year general civil statute of limitations for government actions should apply to the filing of the suit in district court to collect the fine imposed by the Commerce Department. Commerce argued that the 5-year statute applied to the initiation of the administrative action before the ALJ at Commerce, and then began to run again after the Commerce decision for the filing in district court, essentially two 5-year statutes. The Fifth Circuit adopted Core's argument and dismissed the case. Three years later the issue was raised again in *United States v. Robert Meyer*,[205] when Commerce was unable to get into court to collect the fine within five years. Meyer moved to dismiss, citing *Core*, but the First Circuit adopted the Commerce Department argument of two separate 5-year statutes and ultimately upheld the imposition of the fine. This division between the two circuits has not been addressed by any other court, although the EAA extension adopted by the House of Representatives in June 1990 included language adopting the *Core* interpretation of one 5-year statute.[206]

The 1988 EAA amendments that provided for appeal of Commerce export control enforcement decisions to the D.C. Circuit did not address the provision providing for separate, *de novo* civil actions to collect the fines. Inasmuch as the process has never been used for collection of export control civil penalties, this oversight probably has little practical impact on the administration of the law. In theory, however, an exporter subjected to a civil penalty that is upheld by the Court of Appeals could take advantage of the *de novo* procedure to attempt to relitigate all of the issues decided by Commerce.[207] For violators of the antiboycott provisions of the law, this remains the only route to judicial review. This anomalous situation is a result of the piecemeal reform of the procedures for administration of the statute and should be resolved as a part of a comprehensive reform of the standards and procedures under the Export Administration Act.

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[201] 50 U.S.C.A app. §2412(f) (West Supp. 1990).

[202] 50 U.S.C.A app. §2410(f) (West Supp. 1990).

[203] 50 U.S.C.A app. §2410(e) (West Supp. 1990).

[204] United States v. Core Laboratories, 759 F.2d 480 (5th Cir. 1985).

[205] United States v. Robert E. Meyer, 808 F.2d 912 (1st Cir. 1987).

[206] H.R. 4653, 101st Cong. 2d Sess., §16 (b), 136 CONG. REC. H3343-54 (1990). This provision was dropped by the conference committee.

## V. Rulemaking Under the Export Administration Act

The EAA exemption from the Administrative Procedure Act means that the Commerce Department is not subject to the notice-and-comment rulemaking requirements that have become the standard for administrative agency action. Section 13(b) of the EAA calls for public participation, including publication of rules imposing controls in proposed form whenever possible.[208] The act separately requires that the secretary keep the public advised of changes with regard to export controls and to consult with a broad range of public groups about the formulation of controls and export control policies.[209] Changes in the licensing requirements have to be published in the Federal Register.[210] Other parts of the act also include publication requirements, including notices for review of the Commodity Control List[211] and foreign availability reviews.[212] The Bureau of Export Administration generally attempts to publish for comment proposed regulations relating to nonsensitive or non-time critical issues. For example, the rules implementing the 1988 changes in the foreign availability provisions went through the notice-and-comment procedure before they became final but Commerce went to some length to indicate that such procedure was discretionary.[213] When Congress considered repealing the APA exemption in the 1979 revision of the EAA, the Assistant Secretary of Commerce for Industry and Trade testified in opposition and stated that the department is "committed to a policy of issuing regulations in proposed form whenever possible. When we must issue regulations with immediate effect, we will still provide meaningful opportunities for public comment."[214]

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[207] This is extremely unlikely because even in the boycott cases the district court has relied on the record of the hearing before the ALJ at Commerce to decide the matter rather than actually relitigating the elements of the violation. *See* United States v. Robert E. Meyer, No. 85-04798 (D. Mass. 1987).

[208] 50 U.S.C.A.. app. §2412(b) (West Supp. 1990). The National Academy of Sciences study recommends retaining §13(b) even after repeal of the APA exemption, NAS Study *supra* note 1 at 193. This report concurs in that recommendation, *see* Recommendations for Reform *infra*.

[209] 50 U.S.C.A. app. §2403(f) (West Supp. 1990).

[210] 50 U.S.C.A. app. §2404(c)(3) (West Supp. 1990).

[211] *Id.*

[212] *Id.*

Changes in licensing requirements compelled by global events or the receipt of national security classified information are not well-suited to the notice-and-comment process. The APA takes cognizance of these circumstances in both the exemption for military and foreign affairs functions[215] and the "...impracticable, unnecessary, or contrary to public interest" exemption[216] from the notice and comment rulemaking requirement. At present, it is within the sole discretion of the Commerce Department to publish proposed regulations for comment. The agency frequently follows the framework of the APA rulemaking provision, but it is doing so at its discretion and without any external compulsion, oversight, or verification.

Commerce regulations and rulemaking are also exempt from judicial review by virtue of the APA exemption. The Export Administration Regulations provides that any person may submit a request to "issue, amend or revoke a regulation" at any time,[217] but that such requests are not covered by the appeals process described in that section.[218] Thus, there is no formal administrative or judicial mechanism for obtaining review of rules promulgated under the EAA. The American Bar Association resolution of 1986 calling for the addition of judicial review to the EAA commented on several problems relating to rulemaking, including "the failure to offer an opportunity for meaningful public comment on proposed regulations" and "determinations where agency actions do not adhere to the letter or spirit of the authorizing legislation."[219] A number of practitioners expressed concern most recently about failure or delays in Commerce implementation of express Congressional mandates under the 1988 revision to the EAA.[220] Exemption from judicial review renders basic inquiries into fundamental questions of legislative consistency difficult or impossible.

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[213] "5.Section 13(a) of the Export Administration Act of 1979 (EAA), as amended (50 U.S.C. app. 2412(a)), exempts this rule from all requirements of Section 553, including those requiring publication of a notice of proposed rulemaking, an opportunity for public comment, and a delay in effective date. This rule is also exempt from these requirements because it concerns a foreign and military affairs function of the United States. Section 13(b) of the EAA does not require that this rule be published in proposed form because this rule does not impose a new control. Further, no other law requires that a notice of proposed rulemaking and an opportunity for public comment be given for this rule.

Because of the importance of the issues involved, however, this rule was published in proposed form and public comments were solicited. Although there is no formal comment period on this final rule, additional comments from the public are always welcome." 55 Fed. Reg. 32899, 32905 (1990).

[214] *United States Export Control Policy and Extension of the Export Administration Act: Hearing before the Subcommittee on International Finance of the Senate Comm. on Banking, Housing, and Urban Affairs on S.737 and S.977*, Part III, 96th Cong., 1st Sess. 32-33 (1979) (Statement of Frank A. Weil, Assistant Secretary for Industry and Trade, Department of Commerce).

[215] 5 USC §553 (a)(1) (1990). This exemption for rulemaking has been sharply attacked. The Conference adopted a recommendation for repeal of this broad exemption and the substitution of narrower exemptions for rules involving matters required to be kept secret for national defense or foreign policy reasons. 1 CFR §305.73-5 (1990) *see also* Bonfield, *Military and Foreign Affairs Function Rulemaking under the APA*, 71 MICH. L. REV. 221 (1972).

[216] 5 U.S.C.A app. §553(b)(B) (West Supp. 1990).

# VI. Identifying the Problems

## Introduction

There are three broad procedural concerns with regard to the Commerce Department's administration of the EAA. First is the insulating effect of the exemption from judicial review. Second is the transparency concern, the effect of limited explanation of adverse actions and unavailability of information about actions, either advantageous or adverse, with regard to similarly situated parties. The third area of concern, a separation of functions problem, is the difficulty of obtaining meaningful internal review or oversight without significant prior involvement or prejudgment by the reviewing official. All three are somewhat related, but they tend to manifest themselves differently at different steps of the process. All three would be ameliorated to a greater or lesser degree by repeal of the exemption from the APA. Only the first concern, lack of judicial review, lends itself most readily to legislative correction, and even that raises numerous complicating elements. The transparency problem may require some specific legislative change to address, or may be partially resolved by pressures created by the need for a better developed record for judicial review under the APA. The separation of functions problem may present the most difficulty, especially as the volume of licenses declines, but could be addressed legislatively or administratively if necessary.

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[217] 15 CFR §789.3 (1990).

[218] 15 CFR §789.2(a) (1990).

[219] International Law and Practice Section, Report No. 113 B, Summary of Action of the House of Delegates, 25 (ABA Annual Meeting, August 11-13, 1986). These views were most recently reiterated by the International Law Section of the ABA during House of Representative hearings on the 1990 reauthorization of the EAA. *Export Facilitation Act of 1990: Hearings before the Subcommittee on International Economic Policy and Trade of the House Comm. on Foreign Affairs*, 101st Cong. 2nd Sess. (1990) (Testimony of Grant D. Aldonis on behalf of the section of International Law and Practice, American Bar Association).

[220] The new foreign availability rules published by Commerce after 2 years was one point of criticism, *see* 55 Fed. Reg. 32, 899 (1990). Other concerns were expressed about the failure to implement mandated decontrol of certain categories of products *see Administration said to be lax in complying with Export Control Provisions of Trade Act*, INT'L TRADE REP. Vol. 6 No. 41 1,339 (Oct. 18, 1989).

## A. Absence of Judicial Review

The lack of judicial oversight of the actions of the Commerce Department for the last 40 years lies at the heart of the procedural concerns.[221] The Commerce Department has administered the program secure in the knowledge that its decisions would never be subjected to judicial scrutiny. At this stage of the development of administrative law and process, it seems odd that such a pervasive regulatory intrusion into foreign trade remains free from judicial review. The operating presumption of judicial review that courts have applied to other agencies has been blunted by the express exemption from the Administrative Procedure Act. The foreign affairs implications of the law provide a secondary constraint. The APA exemption reflects Congressional intent to exclude the functions of the law from judicial review, an almost always compelling consideration.[222] The secondary constraint is largely self-imposed by the judiciary in deference to the constitutional role of the executive in foreign affairs. It is worth examining the application of both of these traditional bases for exclusion from review to the current administration of the

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[221] *See generally* Cordell & Ellicott, *Judicial Review Under the Export Administration Act of 1979: Is It Time to Open the Courthouse Doors to United States Exporters?* in NAS Study *supra* note 1, Appendix H at 321-335.

[222] *But see* Dart v. United States, 848 F.2d 217, 221 (1988) "Thus, two EAA finality clauses now reinforce each other. Yet, taken together, these clauses bar judicial review only of functions exercised under the Act and of orders of the Secretary that affirm, modify, or vacate the ALJ's initial decision. The question remains: Is review precluded when the Secretary exercises functions that are not specified under the Act, e.g., when the Secretary issues an order that does not affirm, modify or vacate an ALJ decision? We conclude that review is available in these later circumstances. We base our conclusion on the well-established presumption favoring judicial review and on the particular language, structure and legislative history of the EAA."

EAA as a backdrop to considering reforms that would open the process up to judicial examination.

Barring constitutional limitations, Congress is free to exempt the actions of administrative agencies from judicial review.[223] In the 1949 Export Control Act, Congress exempted the administration of export controls from all but the publication requirements of the 1946 Administrative Procedure Act, at the time a novel and relatively untested effort to harmonize government agency practices. It is clear from that action that Congress intended to preclude judicial review, but some background on that decision is enlightening. The 1949 act was the first post-war codification of the war-time controls. It was not the first enactment of these controls to consider the impact of the Administrative Procedure Act, however. Congress had enacted export controls as part of special war powers, with very short lifespans, and had to renew them continually.[224] In the Second Decontrol Act of 1947,[225] Congress exempted the administration of the export controls from all but two sections of the 1946 APA. One was the requirement that regulations be published, the exception that continues to this day, and the other was the judicial review requirement.[226] Thus, from 1947 until the effective date of the 1949 act, export control actions of the Commerce Department were subject to the judicial review provisions of the Administrative Procedure Act. There is no evidence that judicial review was ever sought by an exporter during this time, however.

When the export control authority was consolidated into a nonemergency statute by the 1949 Export Control Act, the question of the general APA exemption was explicitly addressed, although the judicial review issue was not. Commerce resisted being covered by the APA out of a concern over having its license decisions treated as formal adjudication, subject to individual hearings.[227] Congressional concern centered on whether exporters would have some formal input into general policy decisions about licensing, and some recourse for hardship situations.[228] Congress indicated satisfaction with existing departmental procedures for appeals of licensing decisions,[229] and statutory provisions in the 1949 act for private sector involvement in setting licensing policy.[230] Congress did not expressly address the issue of judicial review in the committee reports on the 1949 act, although the elimination of the 1947 provision indicates that Congress did intend to exclude export control matters from the judicial review provisions of the APA. The two reasons the Congress articulated for adoption of the broad exemption from the APA raise questions about the relevance of that Congressional intent to the question of judicial review today. The 1949 Export Control Act was still regarded as a temporary statute relating to the immediate after effects of World War II.[231] The APA in 1946 excluded from its coverage the temporary emergency laws adopted during the war.[232] The Senate report on the 1949 act defended the APA exemption as "in accord with the policy expressed in section 2 of the Administrative Procedure Act itself" (the emergency laws exemption).[233] Forty years later this statement of Congressional intent is unpersuasive.

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[223] *See* Pierce, Shapiro & Verkuil, Administrative Law and Process 128-130 (1985).

[224] *See* Berman & Garson *supra* note 33 at 791-2. The authority to control exports was renewed annually.

[225] Second Decontrol Act of 1947, Pub. L. No. 80-188, 61 Stat 321 (1947).

[226] *Id.* §5. "Section 5 exempts from the Administrative Procedure Act the functions exercised under title III of the Second War Powers Act, as amended, and the functions exercised under the Export Control Act, as amended, except for the requirements of section 3 (relating to public information) and of section 10 (relating to judicial review)." Senate Comm. on the Judiciary, *Second Decontrol Act of 1947 Extending Powers to Control Exports and Certain Powers Under Title III, Second War Powers Act, Report to accompany S.1461*, 80th Cong., 1st Sess. 34 (1947).

[227] *Extension of Export Controls: Hearings before a Subcommittee of the Senate Comm. on Banking and Currency on S.548*, 81st Cong. 1st Sess. 199-200 (1949) (Testimony of Mr. Ostroff, General Counsel, Office of International Trade, Department of Commerce).

The second reason given for the exemption was the export control program's "intimate relation to foreign policy and national security."[234] This echoed the argument of the general counsel of the Office of International Trade in support of the exemption that the APA contained "a general exemption with respect to all matters which have a bearing on foreign affairs such as export controls."[235] This was undoubtedly a reference to the "military, naval, or foreign affairs function" exemption contained in the rulemaking (section 4) and adjudication (section 5) provisions of the APA.[236] No similar exception appears in the judicial review section, however. The general counsel's remark furthers the impression gained from the material that judicial review was simply not an issue considered by the officials focusing on the 1949 act. While this seems unusual from the vantage point of the 1990s, in 1949, barely 3 years after the APA establishment of a presumption of judicial review, the role of the courts in oversight of administrative agency determinations was largely undeveloped. Once again then, while the effect of the addition of the APA exemption was to preclude judicial review, there is no evidence that the preclusion of review was an express element behind adoption of the broad APA exemption in 1949.

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[228] "The essential safeguards of consultation with the trade in promulgating regulations, and of an opportunity to be heard on appeal from hardship, are obtained through the aforementioned provisions of the bill (4b) and existing agency procedures for review and appeals form licensing and compliance actions." S. Rep. No. 31, 81st Cong. Sess. 6 *reprinted in* 2 United States Cong. Svc. 1094, 1100 (1969).

[229] *Id.* Procedures at 15 CFR §378 (1949).

[230] *Id.* Consultation requirement at Pub. L. No. 81-11, §4(b), 63 Stat. 7, 8 (1949).

[231] "There is continued a limited exemption from the Administrative Procedure Act. By section 7, provision is made that section 3 alone (the public information requirement) of the Administrative Procedure Act shall be applicable to the export control program in view of the temporary character of this legislation and its intimate relation to foreign policy and national security." S. Rep. No. 31 *supra* note 228 at 6.

[232] Pub. L. No. 79-404, §2(a) 60 stat. 237 (1946). "Except as to the requirements of Section 3 (publication), there shall be excluded from the operation of this Act... (4) functions which by law expire on the termination of present hostilities, within any fixed period of time thereafter..."

[233] Sen. Report 31, *supra* note 228 at 6.

[234] *Id.* at 6.

[235] *Extension of Export Controls*, testimony of Mr. Ostroff, *supra* note 227 at 199.

Whatever the pedigree of the statutory exemption from judicial review, it is immediately remediable through legislation. Repeal of the exemption from the APA as urged by the National Academy of Sciences would automatically open the act up to review.[237] The more limited American Bar Association recommendation of 1986 to eliminate the judicial review exemption,[238] and the judicial review provision of the House of Representatives bill extending the EAA in 1990[239] would also effectively open up the export control process to judicial scrutiny.[240] If courts were empowered to review export control actions of the Commerce Department, the next question necessary to consider is the extent to which they would exercise the authority. This implicates the second element of the judicial review issue, the traditional deference of courts to the decisions of the executive in matters of foreign affairs.

The seminal case defining the President's foreign affairs authority was an early export control case concerning the proper delegation of authority to the President to restrict the foreign sales of munitions. In Justice Sutherland's opinion in *United States v. Curtiss-Wright Export Corp.*[241] the Supreme Court found a basis for the President's authority in the area of foreign affairs grounded in the nation's sovereignty and outside the framework of the constitution. This court's deference to executive power to control foreign commerce in political contexts has provided a basis for consistent judicial restraint in considering challenges to the exercise of that authority.[242] Three years later, in *Chicago & Southern Air Lines v. Waterman S.S. Corp.*,[243] the Supreme Court addressed its ability to review a decision of the President's under authority clearly granted by Congress, in this case allocation of foreign air routes. In declining to review the decision awarding the route, the court found that the combination of the President's delegated authority over international air routes and his inherent authority over matters relating to foreign affairs rendered the acts of his agent in this context "unexaminable".[244] Congress' broad grant of authority to the President in the EAA over exports combined with this inherent foreign affairs powers raise questions about the extent of judicial review if it were available.[245] Which decisions of the Commerce Department would the courts feel qualified or empowered to review? This question is key to this report and its recommendations.

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[236] Pub. L. No 79-404, §§4(1), 5(4), 60 Stat. 237 (1946) *presently codified at* 5 U.S.C.A app. §§553(a)(1), 554 (a)(4) (West Supp. 1990).

[237] NAS Study *supra* note 1 at 193.

[238] Report No. 113 B *supra* note 34.

[239] H.R. 4653 §18, *supra* note 35. The compromise language of the Conference Report would not provide significant review however. *See supra* note 36.

[240] Congress has recently moved somewhat in the opposite direction, excluding from judicial review State Department decisions whether or not an item is a defense article, *see* note 78 *supra*.

[241] 299 United States 304 (1936).

There are two parallel avenues of judicial activity that provide a useful reference point for considering judicial review of Commerce Department export control decisions. One is the very detailed system of judicial oversight established for reviewing administrative decisions relating to imports, and the other is judicial treatment of administrative national security or foreign policy decisions under the Trading With the Enemy Act (TWEA)[246] and the International Economic Emergency Powers Act (IEEPA).[247] The types of decisions made by the Commerce Department in the administration of export controls include elements from both varieties of actions, although neither approach provides a completely satisfactory model for export controls decisions.

On the import side of international trade, administrative decisions by Customs officials have long been reviewable in court. In particular, Customs determinations of which category under the tariff schedule the item falls into (classification), and the value of the item for purposes of assessing the tariff (valuation), have been litigated extensively.[248] These decisions involved primarily factual questions whose impact was almost exclusively on the United

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[242] "Economic sanctions programs have generally been quite successful at shrouding themselves in the constitutional mystique of the foreign affairs powers of the Executive and the needs of national security." Malloy *supra* note 32 at 537-38.

[243] 333 United States 103 (1948).

[244] *Id.* at 111.

[245] *See generally* Henkin, *supra* note 14, 205-224 ("The Courts in Foreign Affairs").

[246] 50 U.S.C.A app. §§1 *et seq.* (West Supp. 1990).

[247] 50 U.S.C.A app. §§1701 *et seq.* (West Supp. 1990).

[248] *See* Re, *Litigation Before the United States Court of International Trade*, reprinted at 79 U.S.C.A. XI, XVIII-XXV (1990). Judge Re is the Chief Judge of the United States Court of International Trade.

States importer. The Trade Agreements Act of 1979[249] established a system for judicial review of administrative decisions relating to the determination of dumping or subsidization[250] of exports by foreign states or businesses. Factual findings of dumping or subsidy result in higher import duties on the goods from the foreign state. This determination has a significant impact on the conduct and economic prospects of the foreign nation, and directly implicates United States foreign policy.[251] The Customs Court Act of 1980 created the Court of International Trade and gave it specific authority to review all of these administrative decisions, while providing detailed instructions on procedures, standard of review, and burden of proof.[252]

Obviously, Congress does not believe that administrative decisions which affect foreign policy have to be insulated from judicial review. The laws and administrative activity involving imports that were the subject of the 1980 Customs Court legislation are much more closely tied to economic regulation than to national security concerns, but several aspects of the administration of export controls under the EAA closely resemble those activities.[253] More important is the judicial review of administrative activities that do directly impact on national security, the other track to be discussed.

Under the Trading With the Enemy Act, the Treasury Department exercises licensing controls over a range of foreign commercial activity by United States companies through the Office of Foreign Assets Control.[254] These controls apply to nations generally considered to be among the least friendly to the United States and subject to the strictest controls under the Export Administration Act. Yet decisions of the Treasury with regard to licensable activity are reviewable in federal court.[255] In 1975 the Fifth Circuit reversed a licensing decision of the Secretary of the Treasury on the grounds that he had exceeded his statutory authority under TWEA.[256] Most recently a Treasury decision to deny Capital Cities/ABC the right to broadcast the Pan American Games from Cuba in 1991 was reviewed by a federal district court and upheld.[257] While great deference is given the decisions of Treasury, the offended party is able to obtain a hearing in court.

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[249] Pub. L. No. 96-39, 93 Stat. 144 (1989) codified at 19 U.S.C.A. §§2501 *et seq.* (West Supp. 1990).

[250] 19 U.S.C.A. §1516a (West Supp. 1990), Trade Agreements Act of 1979, Pub. L. No. 96-39 §1001, 93 Stat. 300-07 (1979) as amended by Customs Court Act of 1980, Pub. L. No. 96-417, §§601, 608, 94 Stat. 1727 (1980). *See* Re, *supra* note 248 at XXV-XXXII.

[251] *See generally* Jackson & Davey, Legal Problems of International Economic Relations 648-788 (1986).

[252] Pub. L. No. 96-417, §§601, 608, 94 Stat. 1727 (1980).

[253] Classification of the export commodity is the most obvious, see *supra* note 27. Foreign availability assessments involve inquiries about foreign economic activity similar to those undertaken in dumping and subsidy investigations. Also, some of the inquiries into policies of the countries of destination of controlled goods resemble inquiries into the subsidization policies of nations in countervailing duty investigations.

[254] 31 CFR Part 500 - Foreign Assets Control Regulations (1990). *See generally* Malloy, *supra* note 32 at 136-48.

[255] *See* Malloy, *supra* note 32 at 542-79 (discussion of court decisions reviewing Treasury actions implementing TWEA assets controls).

Judicial review is similarly available for Executive Branch decisions under the International Emergency Economic Powers Act.[258] In fact, one of the cases in which this review was exercised examined the denial of an export license by the Commerce Department after the Export Administration Act had expired and the regulations had been extended by President Reagan through an executive order issued under the authority of IEEPA.[259] In *Nuclear Pacific, Inc. v. the Department of Commerce*,[260] a federal judge in the Western District of Washington denied a Commerce Department motion to dismiss the appeal of its denial of an export license to Nuclear Pacific for lack of jurisdiction. The court found that review was not precluded under IEEPA and that the issues raised were not the kind of intimate foreign policy determinations that courts must refrain from considering.[261] While the decisions challenged may ultimately be those due deference by the courts, the decisions under this most sensitive national security statute have been in favor of judicial review.

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[256] Real v. Simon, 510 F.2d 557, 565 (5th Cir. 1975) ("In line with these cases, we conclude that the Secretary of the Treasury has exceeded his statutory authority in the interpretation and application of the Trading with the Enemy Act in such a manner as to deny these appellants their unrestricted interest in the estate of Urbano Real.")

[257] Capital Cities/ABC Inc. v. Brady, 5 9 United StatesL.W. 2063 (S. Dist. N.Y., No. 89 Civ. 8006) June 29, 1990. ("Finally, OFAC's interpretation of its own regulations to include the proposed transactions from the general licensing provision for news gathering activities is not contrary to the regulations' plain language, and is therefore controlling.")

[258] 50 U.S.C.A app. §§1701-06 (West Supp. 1990). *See* Dames & Moore v. Regan, 453 United States 654 (1981).

[259] Exec. Order No. 12470, 49 Fed. Reg. 13,099 (1984).

[260] No. C84-49R (W.D. Wash. June 8, 1984).

[261] *Id.* at 11 ("IEEPA's legislative history does not clearly and convincingly evidence Congress' intent to permit the President to preclude judicial review. Defendants' interpretation of IEEPA would give rise to a host of thorny constitutional issues. The court will not construe IEEPA as authorizing the President to preclude judicial review since that construction is required neither by IEEPA's text nor its legislative history."). In an appeal of a criminal export control conviction, Spawr Optical challenged the President's authority to extend the EAA rules under the Trading with the Enemy Act, and sought review of a decision that a commodity was on the commodity control list. The firm was unsuccessful on all counts, reflecting a stronger view of the preclusion of review language of the regulations. United States v. Spawr Optical Research, Inc., 685 F.2d 1083 (9th Civ. 1982) *cert. denied* 461 United States 9-5 (1983); 864 F.2d 1467 (1988) ("In this case, the secretary has determined that the Spawrs' mirrors could not be exported without an export license. Right or wrong, the trial court must accept this determination as a matter of law.").

General jurisdiction United States courts, especially district courts, do not have substantial experience with legal issues involving foreign commerce and sensitive foreign policy concerns. While they are not institutionally incapable of reviewing the decisions of the Commerce Department under the Export Administration Act, judicial review will introduce problems of consistency and policy sensitivity as well as issues relating to the extensive use of classified information by Commerce in its national security-based decisions. These factors argue against the kind of district court *de novo* review currently available for the rare appeal under TWEA or IEEPA, as does the need for speedy resolution. The national security component and need for timely review similarly argue against two-tier review process of the Court of International Trade and Federal Circuit Court of Appeals. The final section of recommendations will consider these questions about the nature and impact of judicial review.

There is no way to gauge the type or number of issues that might reach the courts if judicial review were generally available. The relative disuse of the internal appeals process at Commerce is no guide because an appeal to the chief policymaker, whose decision is final, provides little actual recourse. At least initially there might be a significant number of such appeals.[262] A brief review of the steps of the licensing process that might generate such appeals provides some insight into the dimensions of the problem.

As indicated *supra*,[263] the decisions about which countries to target for controls and which technologies to control are not prime candidates for judicial review because they deal so intimately with foreign policy matters. Nonetheless, given the history of Congressional concern about the export control program, a court might usefully examine the extent to which

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[262] With decontrol resulting from changes in Eastern Europe and the Soviet Union, the number of license denials has declined dramatically over the last 5 years, from 835 in fiscal year 1985 to 216 in fiscal year 1989. Export Administration Annual Reports 1985, at 15 and 1989 at 22. This trend should continue as decontrol accelerates, with Commerce officials speculating on a 50% reduction in required validated licenses. *See Commerce to Issue Rules Next Month Decontrolling Bulk of West Trade*, INT'L TRADE REP. Vol. 7 No. 3, 66 (Jan. 17, 1990); *CoCom Agrees to Rewrite Export Rules 'From Scratch,' United States Officials Report*, INT'L TRADE REP. Vol. 7, No. 24, 835 (June 13, 1990). New licensing requirements for chemical and biological weapons materials and missile technology may offset this decline. *See United States Announces New Controls on Exports of CBW-Related Goods, Missile Technology*, INT'L TRADE REP. Vol. 8 No. 11 at 376 (Mar. 13, 1991). Any decline in transactions requiring individual validated licenses may be offset initially by companies taking advantage of the new authority to challenge the Commerce Department.

[263] *See* text accompanying notes 98 to 142.

Commerce is following the legislative dictates of the Congress. This may be particularly appropriate with regard to foreign policy export controls, where Congress has provided a detailed procedure for the President to follow in initiating and implementing the controls.[264]

After the threshold issues of which country and what level of technology to control, judicial review becomes much more appropriate. Questions about the classification of a product and the assignment of the proper Export Commodity Control Number are basically applications of a pre-determined standard to a new set of facts, a determination that lends itself to a substantial evidence review. The process is not dissimilar from the one Customs engages in when it decides which category an import falls into under the Harmonized Tariff Schedule for purposes of determining the appropriate import duty. An important distinction that exists between Customs and BXA decisions, however, is that export control issues arise before the transaction can take place. An importer can pay Customs the liquidated tariff, obtain the goods and then litigate over the disputed amount. An exporter that loses an argument with BXA will not be able to ship the goods and will lose the sale. This argues for a faster route of appeals.

Judicial review of a license denial would present the most difficult problems of administration. It would also have the greatest impact on the process if it forced Commerce into a closer examination and more detailed articulation of the basis for the denial. The difficulty arises for two reasons. One very practical problem is the reliance of the department on national security classified information for some of its decisions. There are legitimate reasons why some information may not be shared with the exporter, but the current "trust me" system of denials based on this information permits Commerce to avoid a hard look at its rationale because no one outside BXA ever sees the determinative data after the decision is made. Judicial review would force Commerce to articulate both the confidential factual basis for its decision, and the policy reasons why those particular facts compel a license denial. Suggestions for treatment of this type of classified material are contained in the recommendations section *infra*.

The other problem is the policy-based denials involving the judgment of the licensing officer and her superiors. These types of decisions are likely to be accorded substantial deference by the courts if they are fully explained in their relation to a particular license denial, but Commerce will be forced to articulate its reasoning for a third party in an adversarial context.

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[264] 50 U.S.C.A. app. §§2405(b) (West Supp. 1990) "Criteria", (c) Consultation with industry", (d) "Consultation with other countries", (e) "Alternative means" and (f) "Consultation with the Congress").

Other bases for license denials, such as disputes over the technical capabilities of a product, or the effectiveness of restrictions on the product or licensee, involve issues quite suitable for judicial review because they are fact-oriented. Similar questions involving foreign availability determinations and revocation of distribution licenses also readily lend themselves to traditional, substantial evidence or arbitrary and capricious standards of review of administrative action.

Our system of administrative law and procedure has vested a great deal of faith in judicial review as the primary means for controlling the practices of administrative agencies. In 1988 Congress decided that the export control enforcement decisions of the Department of Commerce could benefit from the scrutiny of the federal court of appeals. For judicial review to have an impact on the day-to-day administration of the EAA by the Commerce Department, it must be provided for in a way that prevents the department from citing the confidential nature of its information or the foreign policy nature of its decision to cut off review. If Commerce perceives an avenue of justification for its licensing decisions that the courts will not scrutinize, the temptation to channel all of its adverse decisions that way will be overpowering. On the other hand, the review process should not involve minute scrutiny of decision-making details or elements of fundamental policy determinations. The recommendations section develops some approaches that should achieve an effective balance.

## B. Lack of Formal Explanations and Information About Crucial Decisions

While the Commerce Department makes a significant effort to educate and inform exporters about the Export Administration Regulations, formal written explanations of individual actions are rare, and specific information about the treatment of other exporters is available in only the most general terms. In administrative law terms, what this means is that there is virtually no record for review in an individual case, and no basis for comparison of similar treatment of similarly situated parties at any stage of the process. Reforms in this area are a critical predicate to meaningful judicial review.

### 1. Explaining Commerce Department Decisions

The Bureau of Export Administration maintains relatively close contacts with the exporters seeking guidance in the application process, and provides them with oral explanations of problems and adverse decisions.[265] Yet when a classification request is rejected and the commodity is placed in a more restrictive category, or when a license is denied, the written explanation provided the exporter is summary at best. While the EAA requires explanations of agency actions,[266] BXA has interpreted this to mean a minimal recitation of statutory provisions underpinning the decision.

These decisions are the initial agency decision. They are not the product of formal adjudication, nor is it contemplated that they become so, but they are initial outcome of the administrative process at BXA. Any appeals process, including the existing internal appeal, is based on this decision. But there is no written explanation of the BXA decision that the exporter can react to. As discussed *supra*,[267] this permits BXA staff to recharacterize their decision in response to the exporter's written appeal in a fashion that may completely undermine the appeal. By only providing the most general explanation, BXA has eliminated external accountability at the critical initial decision stage. While the decision is on the record, its rationale is not and can be reshaped and rejustified in response to the exporter's attacks. Meaningful judicial review (short of a complete *de novo* proceeding) is virtually impossible without a written basis for the agency's initial decision. The policy also increases the premium on using a knowledgeable insider who can obtain the most complete explanation of a decision and inject some informal accountability based on repeated personal contacts.

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[265] Export Administration Annual Report 1989 *supra* note 112 at 15 ("In any case, an application is never Returned Without Action (RWA) unless the applicant has been contacted and is aware of the situation.") A BXA official informally indicated that exporters whose licenses are denied always know in advance through informal, oral contacts.

[266] 50 U.S.C.A app. §2409 (West Supp. 1990). "Procedures for processing export license applications; other inquiries". Subsection (f)(3) provides:

> (3) In cases where the Secretary has determined that an application should be denied, the applicant shall be informed in writing, within 5 days after such determination is made, of--
>
> (A) the determination,
>
> (B) the statutory basis for the proposed denial,
>
> (C) the policies set forth in section 3 of this Act which would be furthered by the proposed denial,
>
> (D) what if any modifications in or restrictions on the goods or technology for which the license was sought would allow such export to be compatible with export controls imposed under this Act, (E) which officers and employees of the Department of Commerce who are familiar with the application will be made reasonably available to the applicant for considerations with regard to such modifications or restrictions, if appropriate,
>
> (F) to the extent consistent with the national security and foreign policy of the United States, the specific considerations which led to the determination to deny the application, and
>
> (G) the availability of appeal procedures.

The Secretary shall allow the applicant at least 30 days to respond to the Secretary's determination before the license application is denied. In the event decisions on license applications are deferred inconsistent with the provisions of this section, the applicant shall be so informed in writing within 5 days after such deferral."

[267] *See* notes 177-79 *supra* and accompanying text.

The anticipated decline in the number of individual validated export licenses handled by the department should free up whatever additional resources may be required to provide written explanations. Detailed suggestions for this process are included in the recommendations *infra*. If BXA has the kind of legitimate explanations officials maintain they provide to exporters orally, committing them to paper should not create a significant burden on the agency.

## 2. Treating Similarly Situated Parties the Same

The second aspect of the transparency problem is the impossible task exporters have in trying to prepare applications and arguments based on past BXA treatment of similar commodities. An exporter applying for a license for a piece of technology that she has never sold abroad must approach the department without the benefit of any detailed knowledge of how a competitor's similar product (or identical product if the exporter is a reseller) has been treated. Unless the exporter hires an export control practitioner familiar with BXA treatment of that type of technology, the exporter will approach the department relatively uninformed and dependent on what the staff tells her. This may affect the classification of the product as well as the ultimate issuance of the license. The exporter has no way to know if her product was accorded the same treatment as similar commodities.[268]

In theory the Commerce Department could control this problem internally by making certain that every similar product receives the same ECCN and is subjected to the same licensing analysis by the licensing officer. There are recurring stories of virtually identical commodities receiving inconsistent treatment depending on the licensing officer making the decision.[269] Some variables may account for this disparate treatment, such as different end-users, one trustworthy and the other not, intervening shifts in policy towards the market country, or agreement on end-use modification or restrictions in one case and not in another. The difficulty is that neither the exporter nor the court (if judicial review becomes available) has any way to examine the treatment of similarly situated goods. Once again, BXA decisions evade any formal external accountability.

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[268] A recent General Accounting Office Study of informal advice provided by BXA staff revealed a similar problem: "Industry representatives told us Commerce Staff sometimes give inaccurate or inconsistent advice in response to export control questions. Similarly, Price Waterhouse's study of Commerce's district offices found that inconsistent responses from Commerce staff cause problems for companies seeking definitive policy advice on which to base business decisions. Commerce officials also recognize the problem of inconsistent and inaccurate oral advice" United States General Accounting Office, Export Controls: Opportunities for Inspiring Compliance with Export Administration Regulations at 12 (Dec. 1990).

The EAA provides for confidential treatment of information provided by exporters in the licensing process.[270] Only that information the Secretary deems necessary in the national interest may be publicly released. Currently the department publishes in its annual report a general list of commodities licensed to each restricted nation, including the CCL number, general description of the items, the number of licenses granted for that type of good and the total dollar value of the licenses for that item for each country.[271] This is useful to gauge the general patterns of licensing for the previous year, but has some serious omissions.

For example, while the number of licenses granted is indicated, the total number applied for in a particular category and number returned without action or denied are not shown. More problematic, the information is only provided in general terms. For example, in fiscal year 1989 Commerce licensed one laser system in CCL category 1522 to the Soviet Union. It had a value of $179,553.[272] Depending on trade press coverage of this sale, another exporter may or may not have any way of knowing exactly what this item was, who was exporting it, and who in the Soviet Union was purchasing it. At the other extreme, Commerce licensed 1,007 computers in CCL category 1565 to the Soviet Union in 1989, with a value in excess of $116 million.[273] While this means the odds are good for exporting that type of computer equipment to the Soviet Union, an exporter whose license is denied is still almost clueless for purposes of comparison.

Commerce has long maintained that the identity of the exporter, her customer, and product details are proprietary information that it will keep confidential.[274] The information released in the annual reports is what Commerce has determined to be in the national interest. While this approach does preserve some important proprietary information, it also provides a shield for the department because it is impossible to tell from the public record if the licensing decisions are consistent. The recommendations section discusses some approaches that would enable exporters to make some useful comparisons to help them predict their chances for success in a license application. Yet this is not where the inability to compare has its greatest impact.

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[269] Almost every practitioner interviewed had at least one first or second hand account of disparate treatment by BXA staff. Many of these examples came from telephone discussions with staff, but a significant number involved actual application responses. Counsel indicated these could often be pursued informally to a supervisory level for resolution.

[270] 50 U.S.C.A app. §2411(c) (West Supp. 1990).

[271] *See* Export Administration Annual Report 1989 *supra* note 112 at Appendix E.

[272] *Id.* at E-8.

[273] *Id.*

If a court is to determine whether or not an agency has acted in an arbitrary or capricious fashion, the court must have access to information about how the agency has treated similarly situated parties. Adding judicial review to the EAA licensing decisions without providing the injured party and the courts access to information about other, similar licenses granted or denied will seriously impede effective review. Some process will have to be devised to assure that Commerce will provide this kind of information to a party that is appealing a classification decision or license denial. The automatic corollary of this is that if Commerce knows that ultimately its consistency will be subject to review in court, the agency will have a much stronger interest in assuring that its treatment of similarly situated parties is the same. While there may be obstacles to making all of the licensing data public, providing access to it by injured parties and the courts may reach some of these concerns.

## C. Separation of Functions

The Bureau of Export Administration is a relatively small agency with a very discrete set of functions to carry out. It is also a very top-heavy agency in its most recent incarnation, with an undersecretary, a deputy undersecretary, an associate deputy undersecretary, two assistant secretaries, and two deputy assistant secretaries performing the functions that one deputy assistant secretary handled as briefly as 10 years ago.[275] One result of this is that the difficult policy questions get worked through the entire chain of command for their resolution, leaving no official to appeal to who has not already been significantly involved in the process. As currently structured, the system encourages informal inquiry and petitions at all stages on important or controversial matters, and leaves only the most mundane decisions to the "formal" appeal process. The result is that relatively few things are formally appealed. This could become a serious problem if judicial review were provided for administrative decisions, and parties were required to exhaust their administrative remedies through the Section 789 appeal process.[276]

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[274] In 1961 newly appointed Secretary of Commerce Luther Hodges instituted a new policy, making publicly available on a daily basis (1) a general description of the item approved for export (2) the amount or number of items approved, and (3) the country of destination. Hodges had earlier indicated his intention to disclose the identity of the exporter. Department of Commerce Export Control 56th Quarterly Report 26-27 (1961). The Department discontinued the daily licensing list during the 1970s.

[275] *Compare* Export Administration Annual Report 1980 at ii (Deputy Assistant Secretary for Export Administration; Director, Office of Export Administration; Director, Office of Antiboycott Compliance *with* Bureau of Export Administration organizational chart in Coping with Export Controls 1990, *supra* note 8 at 765 (Under Secretary, Deputy Under Secretary, Associate Deputy Under Secretary, two Assistant Secretaries, two Deputy Assistant Secretaries, seven Office

The separation of functions problem relating to licensing is not unique to BXA, of course. Typically there is a potential problem where the staff that performs the license review and prepares a recommendation is also the staff that supports the appellate decision-maker.[277] Within BXA, an effort is made to rely on the staff of the Office of Technology and Policy Analysis to review license applications denied by the Office of Export Licensing and appealed to the assistant secretary. In theory the reverse process would work for appeals of commodity classification decisions made by OTPA, with OEL providing the staff work for the assistant secretary. This system probably operates effectively for low profile, low stakes license applications, but those are not the ones likely to end up in court if judicial review is extended to the administration of the EAA.

OEL maintains that it will invariably notify the exporter informally when a license application is going to be denied. At that point the knowledgeable exporter (or her representative) begins to work through the hierarchy at BXA.[278] Meetings may begin with the branch chief in OEL and proceed up to

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Directors). In 1980 those officials supervised the processing of 73,318 license applications, compared to 85,215 in 1989. Export Administration Annual Reports, 1980 at 6, 1989 at 22.

[276] This would be a particular problem given the current lack of any kind of record for appeal or limits on the Assistant Secretary's contacts in deciding the appeal. Adding judicial review, given the exhaustion requirement, without internal reforms at BXA could result in an exporter being compelled to formally appeal to an individual who has already informally told her no. This will not enhance the procedural fairness of the export control regime.

[277] *See generally* Shulman, *Separation of Functions in Formal Licensing Adjudications*, 56 NOTRE DAME LAWYER 351, 388-403 (1981). Export licenses are informal adjudications, so the legal control is somewhat different but the fairness problem, and the perception of fairness problem, is quite similar.

[278] *See* Berlack, *The Applicant's View of the Licensing Process* in Coping with Export Controls 1990, *supra* note 8 at 136. The process of knowledgeable Washington lawyers meeting informally with agency staff is not unique to BXA of course. All of the practitioners interviewed were personally familiar with staff at all levels of BXA and made frequent use of their relationship. What distinguishes this situation is the very limited size of the knowledgeable bar and agency, the stakes involved in these export transactions, and the total absence of external

the undersecretary depending on the importance and sensitivity of the issue. If the Department of Defense is involved, the exporter may meet with officials of the Defense Technology Security Administration and secretarial officials at the Pentagon as well. Sufficiently important issues, or active exporters, may attract the attention of interested members of Congress who provide BXA with their perspective on the merits of the license application.[279] If all of these efforts are ultimately in vain and the license denial initially indicated by OEL staff is issued, the exporter's case has already been before the official charged with responsibility for hearing appeals of such adverse agency actions.

Before the export licensing function was separated from the International Trade Administration at Commerce, the official hearing appeals was the Assistant Secretary for Trade Administration. This person was responsible for the export and import regulatory programs at Commerce (the dumping and subsidies investigations on the import law side). While a central policymaker on export control matters, the official had a much wider range of responsibilities, which resulted in far less daily involvement in licensing decisions. If the assistant secretary had been involved in a matter, an appeal could be referred to the Under Secretary for International Trade. This official was responsible for the entire range of trade-related activities at the department and dealt with export control issues primarily at the broad policy level.

The Bureau of Export Administration was created by the 1985 amendments to the EAA to give greater emphasis to the export control functions of the Commerce Department and to isolate them further from the trade development and promotion functions of the other parts of the International Trade Administration.[280] One inevitable result has been much greater involvement by the most senior officials in the more routine aspects of the licensing process because of their far narrower areas of responsibility. They are more likely to have considered a problem or issue raised by a sensitive license application and are more readily accessible to exporters and their representatives because export controls are their only area of responsibility. This problem is likely to worsen dramatically if the projected 50 percent decline in the need for individual validated licenses occurs.[281] Making use of the section 789 appeals process in this context is not an especially attractive prospect for an exporter who has just had her license rejected by the official to whom she must now appeal. Combine this with the

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accountability for BXA officials. Whatever deal a lawyer can work out meeting with officials is going to be the best deal available.

[279] *Id.* at 141-42.

[280] Export Administration Amendments of 1985, Pub. L. No. 99-64, §116(a), 99 Stat. 120 (1985).

[281] *See* note 262 *supra*.

ready familiarity of officials in a small bureaucracy and the total lack of restraint on *ex parte* contacts in the appeals cases and the prospects for meaningful appeal appear quite bleak. Possible approaches to this third problem in the licensing procedures of BXA will be discussed in the recommendations section.

# VII. Recommendations for Reform[282]

1. Repeal the exemption from the Administrative Procedure Act contained within the Export Administration Act.

2. Provide for judicial review of Commerce Department decisions under the EAA to the United States Court of Appeals for the Federal Circuit.

3. Provide for a uniform Administrative Procedure Act standard of formal adjudication for enforcement actions, including *ex parte* license suspensions and revocations, and make EAA penalty determinations self-executing.

4. Provide for informal adjudication and administrative review procedures for licensing and classification determinations that will assure sufficient notice to all parties of the basis for decisions and provide an adequate record for judicial review.

5. Provide for rulemaking procedures that will maximize public input notwithstanding the military and foreign affairs exemption of the Administrative Procedure Act.

## Introduction

The central proposal of this report is that the administrative actions of the Commerce Department in implementing the Export Administration Act be subject to judicial review. All five of the recommendations outlined above directly relate to that change. The first recommendation would place the department's action under the EAA on the same footing as the vast majority of government regulatory processes subject to the Administrative Procedure Act. The second recommendation fixes the location of judicial review in the Court of Appeals for the Federal Circuit. The third, fourth, and fifth recommendations relate to the way the department should deal with formal and informal adjudication and rulemaking under the proposed APA application. These proposals relate both to changes necessary to conform to the requirements of the APA and to develop an administrative record sufficient for judicial review.

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[282] These recommendations generally track the final recommendations adopted by the Judicial Review Committee of the Conference. The most substantial differences involve my suggestions for refinements of the agency internal appeal process.

## A. Repeal the Exemption from the Administrative Procedure Act contained within the Export Administration Act[283]

The National Academy of Sciences recommended the outright repeal of the exemption from the APA contained in the Export Administration Act.[284] Earlier efforts to add judicial review to the EAA have continued the general exemption from the APA.[285] Broad reform of the Commerce Department's administration of the law requires complete repeal of the exemption rather than just extending the reach of judicial review. While certainly the chief effect of this will be to provide for judicial review of all of the department's actions under the EAA, other significant benefits will also follow. The agency will be required to conform its overall procedures for formal and informal adjudication as well as rulemaking to widely recognized standards of administrative fairness.

There are three considerations in repealing the 40-year-old exemption from the APA rather than just adding judicial review. The first is that there is no longer any reason for the exemption. The original rationale for the exemption, the notion that in 1947 export controls were temporary emergency laws, has long since become nonsense. The 1946 APA is now a proven standard with judicially refined applications designed to assure the regulated public of procedural fairness. The second consideration in eliminating the exemption is that the APA itself includes exceptions, especially for military and foreign affairs functions,[286] that would apply to those most sensitive national security or foreign policy determinations made by Commerce under the EAA. The third consideration is that many of those functions of the department that would be newly subject to the APA are already being conducted in a manner consistent with the requirements of the act.

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[283] The first recommendation of the Judicial Review Committee of the Administrative Conference provides: "Repeal of APA Exemption. Congress should repeal section 13(a) of the Export Administration Act, which exempts functions exercised under that Act from the administrative process and judicial review provisions of the Administrative Procedure Act *(APA)* (5 U.S.C. §§551, 553-559, 701-706)."

[284] NAS Study, *supra* note 1 at 193.

[285] *See* H.R. 4654, *supra* note 35; ABA section of International Law and Practice Report 113B, *supra* note 34.

The origins of the exemption have been discussed.[287] The chief rationale for its adoption was the anticipated temporary nature of the export control laws. The other concern raised by the Commerce Department in 1949 was that each license determination would be subject to the formal adjudication requirements of section 554 of the APA. At the time, the concept of informal adjudication was largely undeveloped. Further a significant part of the export control process was economic in nature, to protect against domestic shortages. The EAA licensing decisions today are typical examples of the informal adjudication found throughout the government. In addition the process today involves almost exclusively foreign policy or national security considerations. Licensing is the essential military or foreign affairs function carried out by the Bureau of Export Administration, and as such it would be exempt from the formal process mandates of the APA. The Attorney General's Manual accompanying the APA in 1947 had difficulty envisioning an application of the foreign or military functions exception to the adjudication provision[288] Export licensing for national security or foreign policy would undoubtedly fit that category even if the decisions were not more appropriately considered informal adjudication.

Similarly, BXA rulemaking with regard to the actual implementation of export controls falls squarely within the foreign and military affairs functions exception to the section 553 mandates. Rules relating to those countries that should be the object of controls and those goods that should be controlled are critical components of United States foreign policy, often involving multilaterally negotiated requirements. The Attorney General's Manual indicates a somewhat better grasp of the scope of this exception: "In the light of the legislative history, it would seem clear that the exception must be construed as applicable to most functions of the State Department and to the foreign affairs functions of any other agency."[289] Consistent with the National Academy of Sciences recommendation however, the current provision of the

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[286] *But see* proposal for repeal of the rulemaking exemption discussed *infra* at text accompanying notes 294-96.

[287] *See* text accompanying notes 224-236 *supra*.

[288] Attorney Generals Manual on the Administrative Procedure Act at 45 (1947).

[289] *Id.* at 26-27.

EAA that urges the greatest possible public consultation on exempt rulemaking should be retained.[290]

Undoubtedly the most sensitive functions of BXA would be exempt from the rulemaking and adjudication requirements of the APA. Other aspects of the administration of the EAA will not be, however, but many of them are conducted consistent with APA standards already. Adjudications for violations of the antiboycott provisions of the act are already subject to the requirements of sections 554 through 557 of the APA,[291] and export control violation proceedings have to be conducted in accord with sections 556 and 557.[292] Some current *ex parte* treatment of license revocations or suspensions would be newly subject to formal adjudication but these actions are not common.[293] While some of the agency's rulemaking would become subject to the APA requirements, it would be the rulemaking that the department treats in most respects consistently with the section 553 dictates, such as foreign availability procedures and antiboycott regulations. The difference would be that instead of Commerce proposing rules for notice and comment at its discretion, the process would be compelled for certain types of rules.

The Administrative Conference of the United States has recommended the repeal of the categorical exemption for "military or foreign affairs functions" rulemaking.[294] The claim of the Bureau of Export Administration that all of its rulemaking would be exempt under that provision is an example of the improperly broad application of the exemption highlighted by the Conference.[295] The Conference's recommendation acknowledges the need for expedited rulemaking and for military or foreign affairs rules that might involve confidential information. The two suggestions included in the recommendation, an exemption for military or foreign affairs rulemaking involving secret matters and a procedure for defining a narrow category of rules exempt when "impracticable, unnecessary, or contrary to public interest,"[296] would accommodate the critical export control rules. Thus, even if the broad military or foreign affairs exemption for rulemaking were repealed, the most sensitive foreign policy rules and those involving national security classified information would continue to be exempt from the notice-and-comment procedures, but subject to existing EAA requirements for consultation.

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[290] NAS Study, *supra* note 1 at 193.

[291] 50 U.S.C.A app. §2410(c)(1)(B) (West Supp. 1990).

[292] 50 U.S.C.A app. §2412(c) (West Supp. 1990). One change APA coverage would make is to include export control adjudications as adversary proceedings under the Equal Access to Justice Act, 5 U.S.C.A app. §504 (West Supp. 1990). Since the civil penalty proceedings for export control violations, unlike antiboycott cases, are not subject to 5 U.S.C. 554, the 9th Circuit has ruled that a successful respondent may not recover attorneys fees from Commerce under EAJA. Haire v. United States, 869 F.2d 531 (9th Cir. 1989).

[293] 15 CFR §770.3(b) "Revocation of Export Licenses and Other Authorizations" (1990).

[294] 1 CFR §305.73-5 "Elimination of the 'Military or Foreign Affairs Function' exemption from APA Rulemaking Requirements (Recommendation No. 73-5) (1990). *See* Bonfield, *Military and Foreign Affairs Function Rulemaking Under the APA* 71 MICH. L. REV. 221 (1972).

[295] *See* BXA rulemaking notice *infra* note 333.

## B. Provide for Judicial Review of Commerce Department Decisions under the EAA in the United States Court of Appeals for the Federal Circuit[297]

While the Administrative Procedure Act mandates judicial review of final agency decisions unless otherwise precluded, it does not specify the nature of the review or the courts to perform the review. The 1988 revisions in the Export Administration Act provided for judicial review of export control enforcement actions by the United States Court of Appeals for the District of Columbia Circuit. The decisions are to be reviewed using a substantial evidence standard for questions of fact, and "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" test for questions of law.[298] This recommendation is to extend that approach to judicial review to all of the agency functions under the act. The Court of Appeals for the Federal Circuit is the best suited court to exercise this review, although the Court of Appeals for the District of Columbia Circuit would also be an appropriate court. Whichever is chosen should, of course, have review jurisdiction over all administrative actions taken by the Commerce Department under the EAA.

There are four considerations in recommending that judicial review be carried out at the Court of Appeals level. The chief concern is finding the most appropriate court to review the sensitive and complex questions that might be involved in appeals of classification or licensing decisions by the Commerce Department. The second concern is choosing a judicial review process that would be the least disruptive of the operations of the department. The third concern is whether there would be a sufficient record of the

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[296] 1 CFR §305.73-5, Recommendation No. 2 (a), (b) (1990).

[297] The second recommendation of the Judicial Review Committee of the Administrative Conference provides: "II. Judicial Review. Congress should amend the Export Administration Act to provide for judicial review in a single forum, the United States Court of Appeals for the Federal Circuit, of all Commerce Department actions (including the imposition of civil penalties) under the Act that are reviewable by the standards of APA section 706."

[298] 50 U.S.C.A. app. §2412(c)(3) (West Supp. 1990).

Commerce Department decision process to permit review on the record rather than a *de novo* review. The fourth concern is identifying a review process that could be utilized quickly enough to be meaningful for individual transactions wholly dependent on government approval.

Adoption of these recommendations would cause both the Commerce Department and affected exporters to lose some procedural rights they might rather retain under a different system. The Commerce Department would no longer be making final, unreviewable decisions, and would have to adopt internal procedures that provide far more formal notice and explanation of decisions. Exporters would benefit from these changes, but by not having *de novo* judicial review of Commerce decisions in federal district court, exporters would lose opportunities for discovery, confrontation, and cross-examination that they might regard as a more effective method of review. Commerce gains from not being subjected to the disruptive litigation rigors accompanying *de novo* review.

The specific recommendations about improving the decision process within the Commerce Department are presented below. If implemented they would result in a substantial agency record that would provide ample basis for judicial review by the court of appeals. Their adoption is a critical part of the formula for judicial review and should not be considered as a severable recommendation.

Court of appeals review of administrative decisions that do not involve an APA formal adjudication is unusual,[299] but important in this situation because of the unique blend of commercial regulation and foreign policy embodied in the Export Administration Act. District court judges will be both more and less likely to recognize foreign policy or national security questions and defer to Commerce on them. Some courts would find unreviewable policy questions in every case and refuse to consider appeals seriously, while others would seek to impose broad discovery demands on all aspects of Commerce operations and consider every element of the agency's decisions. The majority would fall somewhere in between, but with little consistency or pattern.

*De novo* review in district court could also present some problems. A trial on these issues would be very disruptive to Commerce as exporters sought to probe the decision-making process through discovery.[300] The recommendations for reforms in the process at Commerce are designed to establish a record sufficient for review and eliminate the need for additional fact-finding by the court on appeal. Exporters will not have the opportunity to elicit information from the department in an adversarial environment refereed by an independent judge, but that process is not appropriate to the kinds of issues being decided under the EAA.

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[299] *See* Currie and Goodman, *Judicial Review of Federal Administrative Action: Quest for the Optimum Forum*, 75 COLUM. L. REV. 1, 54-61 (1975). Professors Currie and Goodman focus on the absence of an agency record as the primary reason informal adjudication is most often reviewed of the district court level. This proposal seeks to cure that problem through forcing Commerce to document the reasons for adverse actions.

Another possibility is the Court of International Trade model, where that district level court considers appeals of Commerce Department decisions relating to import regulation and Customs Bureau classification and liquidation decisions on the agency record under a substantial evidence test. Appeals can be taken from the CIT to the Court of Appeals for the Federal Circuit.[301] While giving exclusive jurisdiction to the CIT would address the inconsistency concern, there is no reason to create a two-tier system of review on the record.

The speed of review is a consideration in recommending Court of Appeals review on the record. Unlike appeals of Customs liquidations where an importer can pay the tariff Customs assigns and then litigate over the difference through the CIT, a license denial by Commerce means no transaction. While an exporter might find it more convenient to file an appeal with her local federal district court, the combination of very crowded dockets and the likelihood of Commerce appealing an adverse decision to the court of appeals level make district court appeals even limited to the CIT, unattractive. There is no quick method of appeal under any circumstance, but obtaining review on the record in the court of appeals should facilitate the process.

The Conference has adopted a recommendation stating criteria for Congress to use in determining the appropriate forum for judicial review.[302] One of these suggestions is that informal administrative actions, like product classification or licensing, be reviewed in the first instance at the district court level, unless all of three conditions are met.[303] The first condition, that the issue of law have a broad social or legal impact,[304] would be met by the foreign policy implications of EAA appeals. The second, that an evidentiary record need not be developed,[305] would be met by the adoption of the recommendations for reform of the internal procedures at BXA. The third condition, that appeals be few in number or likely to reach the court of appeals anyway,[306] would probably be met on both elements. The number of potential appeals is hard to gauge but necessarily limited to those who have business licenses denied or adverse classification decisions. Any exporter with a large enough transaction at risk to appeal to one court will likely be prepared to take it to the next level as well. Thus this recommendation is consistent with the standard the Conference recommended Congress apply in determining where to lodge appellate jurisdiction.

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[300] Criminal defendants have been almost completely unsuccessful in their efforts to explore the licensing decision processes of the Commerce Department. *See* United States v. Spawr Optical, 864 F.2d 1467 (9th Cir. 1988). *But see* United States v. Mandel, 696 F.Supp. 505 (E.D.Cal. 1988). The trial judge granted defendant's discovery motion against the Commerce Department on the question of the item being properly on the Control list. Commerce appealed the decision and the 9th Circuit reversed. Central to both these cases was the political nature of the listing decision and the proper deference due the agency.

[301] 28 U.S.C.A. §2645 (West supp. 1990).

[302] 1 CFR §305.75-3 "The Choice of Forum for Judicial Review of Administrative Action (Recommendation No. 75-3)" (1990).

[303] *Id.* Recommendation No. 6(a), (b).

Selection of the appropriate court of appeals to hear questions under the Export Administration Act involves a great deal of speculation about the nature of the issues that will be raised to appeal. These matters should be heard in one court for reasons of consistency and development of some subject matter expertise. That court should be one both familiar with administrative law and procedure questions and sensitive to issues that impact often delicate foreign affairs matters. Either the D.C. Circuit or the Federal Circuit would be appropriate on that standard. What is not clear is if the issues appealed would involve primarily questions about when to defer to the executive on national security or foreign policy issues, or relatively technical questions regarding the nature and classification of technology sought to be exported.

While the Court of Appeals for the District of Columbia Circuit is traditionally regarded as the appropriate appellate court for administrative law matters and those involving sensitive policy or constitutional issues, a review of all the relevant factors likely to impact on Export Administration Act appeals indicates that the Court of Appeals for the Federal Circuit has a distinct advantage. First, the Federal Circuit by a large margin considers the most administrative law cases of all the circuits.[307] Second, it has a significant foreign affairs docket already. The import regulation and Customs appeals the court hears have far-reaching foreign policy implications. The court has developed a knowledge of many of the nuances of international trade that will be useful in EAA decisions, and has had to deal with complex issues that will dramatically effect our relations with our foreign trading partners.[308]

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[304] *Id.* No. 6(b)(i).

[305] *Id.* No. 6(b)(ii).

[306] *Id.* No. 6 (c)(iii).

[307] Schuck & Elliott, *To the Chevron Station: An Empirical Study of Federal Administrative Law*, Administrative Conference of the United States at 18 (1990).

Finally, the expertise the court brings to high technology patent cases will be a significant asset in considering questions relating to the appropriate technological categorization of advance technology products. The availability of this expertise should assure critics concerned about opening up complex EAA licensing issues with national security implications to judicial review that such review will be scientifically as well as judicially competent.[309] This factor is probably the strongest reason to lodge jurisdiction over Export Administration Act matters with the Federal Circuit.

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[308] *See* Cohen, *International Trade Decisions of the United States Court of Appeals for the Federal Circuit During 1989*, 39 AMERICAN U. L. REV. 1171, 1172-1204 (1990).

[309] *See* Plager, *The United States Courts of Appeals, the Federal Circuit, and the Nonregional Subject Matter Concept: Reflections on the Search for a Model*, 39 AMERICAN U. L. REV. 853, 860-65 (1990). *See generally* Chartove, *Patent Law Developments in the United States for the Federal Circuit During 1989*, *Id.* at 1075.

### C. Provide for a Uniform Administrative Procedure Act Standard of Formal Adjudication for Enforcement Actions, including *ex parte* License Suspensions and Revocations, and make EAA Penalty Determinations Self-executing[310]

This recommendation will affect three different aspects of enforcement and administrative activity under the EAA. The first will be to harmonize all formal adjudications under the statute. The second will be to require formal adjudication in some situations where it is not now used. The third will be to eliminate a cumbersome and confusing system for imposing and collecting civil money penalties.

The piecemeal amendment of the EAA procedures over the years has resulted in a number of anomalies. While export control and antiboycott enforcement actions were both made subject to sections 555 to 558 of the Administrative Procedure Act at different times, section 554 only applies to antiboycott actions[311]. This has lead one court to decide that the Equal Access to Justice Act does not provide for attorneys fees for parties successfully defending export control enforcement actions.[312] Amendments providing for judicial review of export control enforcement actions in the Court of Appeals for the D.C. Circuit left intact the *de novo* appeal in federal district court of antiboycott enforcement actions.[313] A uniform application of the APA formal adjudication requirements to all such actions by Commerce should follow automatically from repeal of the APA exemption urged in the first recommendation. But because of the existing partial incorporation of APA standards, care will have to be taken in legislating such a change to achieve the desired consistency.

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[310] The fourth recommendation (third in my order) of the Judicial Review Committee of the Conference provides:

> "IV. Formal Adjudications. A.) Congress should amend the Export Administration Act to provide the right to a prompt post-denial (or post-suspension) hearing on the record, subject to the formal adjudication provisions of the Administrative Procedure Act, for parties subject (1) to unilateral Commerce Department decisions to suspend or revoke validated licenses when the suspension or revocation turns on the specific circumstances of a particular exporter or commodity, or (2) to temporary denial orders under section 13(d) of the Export Administration Act. Congress should establish appropriate deadlines for the conduct of such hearings.
>
> B.) The Commerce Department should, to the extent possible, limit the scope of unilateral license suspensions and temporary denial orders to the circumstances posing a threat of violation of the Export Administration Act.
>
> C.) Congress should amend the civil penalty provisions of 50 U.S.C. App. §§2410 and 1412 to eliminate the requirement of de novo review in federal district court and provide instead that any assessment of civil penalties is final and subject to collection by the agency, subject to judicial review under 5 U.S.C. §706 in the Court of Appeals for the Federal Circuit."

[311] *See* text accompanying notes 87-95 *supra*. *Compare* 50 U.S.C.A. app. §2410 (c)(2)(B) *with* §2412 (c)(1)(West Supp. 1990).

[312] Haire v. United States, 869 F.2d 531 (9th Cir. 1989).

Probably the most significant recommended change in this area is the application of the formal adjudication requirements to license revocation and suspension activities of the department not now subject to formal hearing requirements. While current rules require a post-denial formal hearing when Commerce issues an *ex parte* order denying export privileges,[314] the recommendation would also provide for such a hearing whenever Commerce suspended or revoked a license based on a determination specific to that transaction or exporter.[315] This may have the most immediate direct impact on treatment of distribution licenses which can now be suspended or revoked without any requirement for a formal hearing before an administrative law judge.[316]

This requirement would not apply to licenses suspended or revoked because of a policy change with regard to a foreign nation, or a decision to newly restrict a category of technology previously licensed. Such decisions would be subject to administrative and judicial scrutiny under the rulemaking procedures considered below. Where Commerce acts adversely on an *ex parte* basis against an individual licensee, the licensee is entitled to a formal hearing as soon as possible following the action. Commerce should, of course, only act on such a basis where immediate violations or other harmful actions are about to occur.

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[313] Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, §12(c), 102 Stat. 1325, 1325-1371 (1988).

[314] 15 CFR §788.19 (1990).

[315] Pursuant to authority under 15 CFR §770.2(b)(1990).

[316] 15 CFR §773.5(g)(1990).

The third change that this recommendation would bring about is the elimination of the existing procedure for the collection of civil money penalties through *de novo* proceedings in federal district court.[317] This recommendation is consistent with the position of the Conference with regard to these penalties.[318] The existing system is unnecessary once uniform judicial review is provided for all enforcement or penalty determinations. This change will also eliminate the existing confusion over the appropriate statute of limitations for enforcement actions.[319]

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[317] 50 U.S.C.A. app. §2410(f)(West Supp. 1990).

[318] Cf. Conference Recommendation 72-6, "Civil Money Penalties as a Sanction," 1 CFR §305.72-6 (1990); Conference Recommendation 79-3, "Agency Assessment And Mitigation of Civil Money Penalties," 1 CFR §305.79-3 (1990).

[319] *See*, text accompanying notes 201-07 *supra*.

## D. Provide for Informal Adjudication and Administrative Review Procedures for Licensing and Classification Determinations that will Assure Sufficient notice to all Parties of the Basis for Decisions and Provide an Adequate Record for Judicial Review[320]

1. The Department of Commerce should provide specific, substantive written initial explanations to exporters of adverse decisions regarding the classification of commodities and applications for licenses.

2. The Department of Commerce should adopt procedures, consistent with national security and foreign policy requirements, to enable exporters subject to adverse licensing decisions based on classified information to have sufficient access to such information to present an informed appeal. On administrative

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[320] The third recommendation of the Judicial Review Committee of the Conference provides:

> "III. Informal Adjudications. Requests for proper classification of proposed exports and applications for validated licenses or reexport authorizations are appropriately treated as informal adjudications under the APA. The Department of Commerce should make the following improvements in the applicable procedures:
>
> A.) Whenever the Commerce Department initially denies a license application or responds to a classification request by placing the item in a category different from that proposed by the requester, it should provide sufficient written explanations for its decisions to enable applicants to understand the basis on which decisions have been reached and pursue internal appeals.
>
> B.) Secretarial review of staff decisions on product classification or license applications should be available on request of the applicant. To the extent possible, the decision on review at the secretarial level should be in detail sufficient to permit others to evaluate its possible precedential value. To eliminate a duplicative review procedure, Congress should repeal section 13(e) of the Export Administration Act, which provides for limited appeals of license denials through an administrative law judge hearing process.
>
> C.) The Commerce Department should publish and index in an appropriate manner those decisions on requests for classification and individual license applications that have possible precedential value, in addition to general written guidance on classification issues.
>
> D.) When a license application has been denied, or has been the subject of negative considerations or recommendations under section 10(f)(2) of the Export Administration Act, based on classified information, the Commerce Department should adopt procedures to permit the maximum disclosure of such information consistent with national security and foreign policy (including, where appropriate, disclosure to the applicant or applicant's counsel under protective order). On administrative appeal of any license denial based on undisclosed classified information, the Secretary (or the Secretary's delegatee) should personally review the classified information and certify that it is properly classified and supports the action taken."

appeal of any license denial based on undisclosed classified information, the Secretary or the Secretary's delegatee should personally review the classified information and certify that it is properly classified and supports the action taken.

3. The Department of Commerce should make publicly available classification and licensing decisions in sufficient detail to enable other parties to make informed judgments about their own situation.

4. The Department of Commerce should continue to provide for administrative appeal of adverse initial staff decisions on classification, licensing, or other informal agency adjudications. Congress should repeal the limited administrative law judge appeal of license denials under section 13(e) of the EAA. The department should consider revisions of its administrative appeal process to provide for fairer process and a better developed record for judicial review.

These recommendations reflect the need for Commerce to continue to provide administrative review but also to provide fuller, formal explanations for its actions and the need for a fully developed record for judicial review. Some changes are needed to reorient the export licensing process towards external accountability consistent with the guidelines under which almost all other administrative agencies have learned to function.

The suggestions for consideration below cut across a wide range of the activities of the Bureau of Export Administration and would require some significant changes in the manner in which BXA operates. While the changes are needed to provide exporters with the same degree of procedural protections available to other United States businesses subject to government regulation, the recommendations should not be read as a condemnation of the Bureau of Export Administration or its attitude toward exporters. BXA is, in many respects, an unusually service-oriented bureaucracy. The extent of its public education efforts and the substantial informal assistance it offers exporters in coping with the controls system indicate the agency's commitment to facilitating exports. Notwithstanding this attitude, the bureau's procedures have evolved over the years into a very informal, insular system that avoids written explanations whenever possible, one that has operated confident in the knowledge that the decisions, almost without exception, are beyond review or challenge outside the department. This has fostered a somewhat paternalistic regulatory culture, where all of the procedures, services and advice offered to exporters reflect the ultimate, absolute authority of the extending agency administering a system of privileges. The recommendations that follow are aimed at injecting a degree of creative tension into BXA practices by having the agency document its decisions, with the knowledge that a court of law may judge them against a broader standard of fairness.

### 1. The Department of Commerce should provide specific, substantive written initial explanations to exporters of adverse decisions regarding the classification of commodities and applications for licenses.

These explanations should be provided, at a minimum, when the decision is inconsistent with the expressed assumptions or expectations of the exporter. The explanation should indicate the reasons for the decision, including an articulation of the policy that provided the basis for the decision if it is grounded in policy. Factual disagreements should be spelled out, along with the basis for BXA's contrary factual assertions.

When the Office of Technology and Policy Analysis (OTPA) decides that the exporter's classification of a commodity is incorrect, the notice of reclassification should indicate the exporter's error and OTPA's basis for the new classification. If the exporter correctly classified the commodity, but did so based on obviously erroneous assumptions, OTPA's classification should also indicate that error. This information is already communicated to exporters informally, according to OTPA staff. It would not have to be exceptionally detailed unless warranted by the complexity of the decision. Customs classifications are explained in some detail and might serve as a model. If OTPA agreed with the analysis and classification conclusion of the exporter, a simple statement to that effect would suffice. This would provide the exporter with a written basis for its reliance should questions arise later.

When the Office of Export Licensing (OEL) rejects a license, or returns it without action, the notice itself should provide the explanation for the action. Currently, exporters are generally advised informally of the reasons through telephone contact or meetings, but these explanations should be committed to writing. Again, the explanation need not be elaborate unless circumstances warrant, but it should be sufficient in and of itself to put the exporter on notice of the factual and policy issues that led to a denial of the license or its return. No explanation is necessary when a license is granted, unless there are express limitations on it. In that circumstance the exporter will already be aware of the reasons, but she should be provided with a written explanation of the basis for the restrictions. This would both facilitate an appeal of the restrictions and protect the licensee in the event questions arise later about the restrictions.

This recommendation would also apply to any staff decision affecting an exporter's license application. Decisions with regard to the foreign availability of a commodity for example should include: a statement that the claim had been accepted for the reasons the exporter provided; if accepted based on different information obtained by BXA an explanation of that information; or if rejected, explanation of why the claim was rejected, including the reasons for disbelieving the exporter's submitted data. Such decisions may require lengthier explanations than simple license denials, but given the requirements and standards applied to foreign availability, merit fuller treatment.

These explanations will provide the exporter with a record of BXA's decision and its justification. This will provide the basis for the internal appeal and it will begin to build a record for judicial review if the internal review is unsuccessful. It will also force BXA to focus its reasoning and decision-making process to articulate succinctly the justification for these adverse decisions. Because the written statement will reflect the formal position of BXA, it will also help the exporter respond informally to the agency in addressing those specific items listed as the basis for the adverse action.

The greatest difficulty raised by this recommendation is how to treat decisions based on classified information. This is particularly a problem for license denials because unless BXA can be forced to offer some explanation when classified information plays a role in its decision, exporters will still be unable to respond to such denials, even informally, and much of the process will continue to be shielded from external review and accountability. There are very legitimate national security concerns here about preserving the confidentiality of intelligence information, but there must be some mechanism to challenge its accuracy and applicability. The following recommendation addresses that concern.

### 2. The Department of Commerce should adopt procedures, consistent with national security and foreign policy requirements, to enable exporters subject to adverse licensing decisions based on classified information to have sufficient access to such information to present an informed appeal. On administrative appeal of any license denial based on undisclosed classified information, the Secretary or the Secretary's delegatee should personally review the classified information and certify that it is properly classified and supports the action taken.

The Department of Commerce is severely limited in its ability to disclose national security classified information that it has used as a basis for a license denial or other adverse action. A negatively affected exporter must nonetheless be given some opportunity to make an informed objection to that determination or the entire licensing process may be funnelled into the classified information domain by Commerce to avoid scrutiny.

The department should be instructed by Congress to make certain that classified information is only used as a basis for a license denial when it forms the essential predicate for the adverse action. Exporters should be alerted in these circumstances to the fact that their license application has been denied for this reason. They should also be told what part of their application raised the problem. At that point the department should make every effort to use a procedure that will permit access to the information so that adversely affected persons may respond to it.

There are procedures in the department currently allowing exporters charged with violations based on classified information to have access to that information for purposes of defending themselves.[321] These rules or some variant should apply to exporters appealing license denials as well.

In those circumstances where there is simply no way, consistent with national security concerns, to provide an exporter access to the information that is the basis for the license denial, the exporter should still be able to appeal the decision administratively and the official hearing the appeal should be required to personally review the information and certify that (a) it is properly classified, and (b) it supports the adverse action in the manner the department staff claims.

It is unusual for national security intelligence information to have such a direct impact on commercial activity, and there is little precedent for balancing these interests.[322] This approach seeks to balance the needs of exporters for information that will permit them to prepare an intelligent appeal and the national security concerns of the government. It is critical to prevent the Department of Commerce from being able to cite such national security intelligence as a basis for licensing decisions without the decision being closely scrutinized. This procedure coupled with the prospect of judicial review by judges who will in fact examine the evidence should induce Commerce to use this basis for license denials as even-handedly as all others that the exporter can challenge fully and openly.

## 3. The Department of Commerce should make publicly available classification and licensing decisions in sufficient detail to enable other parties to make informed judgments about their own situation.

While the previous two recommendations dealt with providing information to a specific exporter about Commerce's treatment of her application, this recommendation concerns the public dissemination of information for the benefit of prospective exporters. Implementing this recommendation means balancing an exporter's interest in keeping the details of her sale a commercial secret, and the interests of all exporters in knowing that the same product is going to be treated the same way by the Commerce Department.

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[321] 15 CFR §788.11 (1990).

[322] *But see* Jaksetic, *Security Clearance Determinations and Due Process*, 12 GEO. MASON U. L. REV. 171, 193-203 (1990).

Commerce currently protects the information it receives on the export license application as proprietary information, and discloses only the most general data. This has been justified on the basis that exporters would be discouraged from seeking export licenses if the information they included would be available to the competitors.[323] The combination of heightened interest in exporting by United States firms, the anticipated dramatic reduction in the number of exports requiring individual validated licenses, and the continuing vigor of enforcement activity make this argument unpersuasive today.

Much of the necessary information could be disclosed without giving away details of individual transactions. For example, Commerce has specific product information and the appropriate Export Commodity Classification Number for each license it issues. An exporter should be able to have access to this information to discover how the item she wishes to export has been classified. Or, if her item has not been classified, she should be able to find out how similar items in the trade she is likely to know have been classified. This data could be available by product, brand and model number and cross-referenced by broader product categories. Explanations provided under these reforms should also be made available. The information would not have to be compiled and published but could be available in electronic form similar to systems Commerce currently uses to keep exporters informed about the status of their license and provide them with other data. Copies of the classification form Commerce provides to the exporter should be made publicly available. Disclosing how a product has been classified should not place any exporter at a competitive disadvantage, unless she was able to obtain a more favorable classification than someone else, an outcome this reform is aimed at correcting.

Disclosing licensing information presents a somewhat more sensitive problem and is not likely to provide as definitive comparative information. There are too many variables in the licensing determination for an exporter to know for certain that if an export were licensed for her competitor to a certain country, it will be licensed for her. That knowledge will allow her to explore fully with Commerce the exact reason for a license denial, however. It is possible to provide this much information without placing the licensed exporter at a competitive disadvantage.

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[323] *See* Commerce Department, Export Control 56th Quarterly Report 28 (1961).

Information about the products licensed and their country destination are the key pieces. A prospective exporter should be able to find out if an Acme Widget Model 5 has been licensed for export to Mongolia in the last 5 years. Less valuable, but still helpful, would be the knowledge that some product in the ECCN category of the Acme Model 5 was licensed to Mongolia in the last 5 years. The name of the end-user or consignee would not have to be available, nor would details of any restrictions on the licenses, although a notation that there were restrictions would be beneficial. Commerce has all of this information, and licensing officers are or should be looking at it when applications are reviewed. Setting up a system to make it available to the public would not be difficult.

The benefits of providing access to this information to exporters is apparent. They would know quickly what their prospects were and would be alerted to discuss with Commerce an apparently inconsistent treatment of their application. The disadvantage is that any other person could browse through the information and discover the controlled nations where the Acme Company had sold its Model 5 Widget. This disadvantage will shrink as the number of controlled nations is reduced. With the elimination of validated license requirements for sales to Western nations, the most critical business information that might have been available is already gone. A company that obtained a license after much struggle might well want to keep that information secret from its competitors, but a regulatory system must be designed to assure similarly situated parties similar treatment. Unless such parties, or the courts reviewing these decisions, know how others were treated, they cannot press the regulatory agency for similar treatment or for convincing reasons for dissimilar treatment.

### 4. The Department of Commerce should continue to provide for administrative appeal of adverse initial staff decisions on classification, licensing, or other informal agency adjudications. Congress should repeal the limited administrative law judge appeal of license denials under section 13(e) of the EAA. The department should consider revisions of its administrative appeal procedure to provide for fairer process and a better developed record for judicial review.

Any nonenforcement adverse action (other than rulemaking) taken by the Department of Commerce under the Export Administration Act is currently appealable by the exporter under section 789.[324] This procedure will take on even greater significance for both the exporter and the department with the advent of general judicial review. The internal appeal process will have to be exhausted by the exporter before judicial review can be had,[325] while the record generated by the department in the process will be closely scrutinized by the court in considering the exporter's appeal.

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[324] 15 CFR §789 (1990).

With better written explanations at the initial licensing and classification decision stages, and judicial review following the internal agency appeal, the resort to the administrative law judge for license appeals provided in §13 (e) and never used[326] should be repealed. All informal adjudication decisions should be appealable internally. Outlined below are some suggested revisions in that process that would make it more responsive to the exporter's needs and assure a substantial record for judicial review without significantly affecting the department's interests in administering the statute.

> a. Any person appealing a nonenforcement administrative decision under the Export Administration Act should be entitled to a hearing before the appropriate official.

Under the current procedures, an exporter may appeal any nonenforcement decision of BXA that directly and adversely affects her to an assistant secretary. This right to appeal should be retained. However, the rules now provide that while an exporter may request an informal hearing, the assistant secretary has discretion to grant or deny that request.[327] This permits the assistant secretary to prejudge the issue and determine which appeals merit a hearing and which do not. It reflects one of the basic flaws in the current system, the intimate familiarity of the assistant secretary with these issues before they are ever formally presented.

The total package of recommendations attempts to offset that as much as is practical. This first recommendation would give every adversely affected party the right to an informal hearing if they desired one. The regulations should provide for an exporter to waive that right and proceed on the written record, but it should be the exporter's option, not the department's.

> b. A complete record of the appeals proceeding should be maintained by the department, including a transcript of the hearing.

Under the current procedures, if an appealing party is granted an informal hearing, she may request that a transcript be made and is responsible for the cost of the transcript.[328] If judicial appeal of Export Administration Act decisions is permitted, both the exporter and the agency will have a strong interest in the court being able to review the complete record of the proceedings before the department. While the exporter should pay the cost of a copy of the transcript, she should not have to bear the cost of transcription. The current policy reflects the attitude that the export license is a privilege granted to the exporter and that the exporter should bear any extra costs associated with obtaining that privilege.

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[325] *See* Pierce, Shapiro & Verkuil, Administrative Law and Process at 190-96 (1985).

[326] *See* text accompanying notes 171 to 179 *supra*.

[327] 15 CFR §789.2(b)(3) (1990).

[328] 15 CFR §789.2(b)(4)(iv) (1990).

c. The decision on appeal should be in writing and should provide the reasons for the decision, including the facts, circumstances, arguments, and policy upon which the decision was based.

Current rules require that appeals decisions be in writing and that they contain the reasons for the action.[329] Current decisions are final, however, and will never be considered as the basis for review by the courts. Department decisions under this proposal would be subject to review by the courts. It would be in the best interests of both the appellant/exporter and the department for the decision to include a thorough discussion of the reasoning and basis for the action.

d. The official deciding appeals should be the most senior secretarial official with responsibility for export control matters.

Appeals should be decided by the official with the least contact with day-to-day operations of the export administration process and the greatest policy-making authority. Currently this would be the Undersecretary for Export Administration. The person hearing the appeal should not have had active involvement in the matter at the initial decision stage. This will enhance the fairness and appearance of fairness of the process. As indicated above, this will become increasingly difficult given the compression of authority within the agency and the pending decline in number of export license applications. However, if the decision of this official is appealable to court, heightened sensitivity to prior involvement may make the undersecretary more cautious about getting involved in routine matters.

Perhaps more important than this concern is to have the appeal decided by the senior export control policy official of the department. License denial issues in particular frequently involve difficult policy determinations. The department will want the courts to defer to the judgment of the department on policy questions. While the courts will already be inclined to defer where the issue can be isolated to a policy question, if that question has been addressed by the senior policy-maker at the department in a reasonable opinion, the deference will be substantial. Thus, the credibility of the decision of the department on appeal, and the likelihood that it will be upheld, will be greater if the matter is decided at the highest level.

e. The official deciding appeals should have no more than 90 days to hear and decide the matter.

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[329] 15 CFR §789.2(c)(1) (1990).

Delays in decisions about permission to export can be very expensive. Commercial transactions that are dependent on securing a validated license may not survive an extended period of review and consideration. Therefore it is critical to place a reasonable limit on the amount of time the department may take in considering an appeal of a classification, licensing, or other agency decision.

Congress has amended the Export Administration Act to impose numerous statutory deadlines for decisions by the Bureau of Export Administration and other agencies involved in reviewing license applications.[330] These deadlines have served more as suggestions, however, than true deadlines, because of the unreviewability of Commerce decisions. If an exporter pressures Commerce to meet a deadline, Commerce can provide the easiest answer, invariably negative, and the exporter is without recourse.[331] If the exporter believes more time may permit Commerce to be satisfied that the export is not a threat to national security, the exporter will not push on the deadline. By introducing judicial review into the process, the existing statutory deadlines will take on new meaning. Exporters will have recourse from arbitrary determinations of the department in response to deadline pressure. Commerce in turn will have the external motivation Congress intended by legislating deadlines. The 90-day limit on appeals is consistent with this approach.

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[330] 50 U.S.C.A app. §2409 (West Supp. 1990).

[331] *See* Daedalus Enterprises, Inc. v. Baldrige, 563 F.Supp. 1345 (D.D.C. 1983); *see also* Hunt & Breed *Export Administration Act: Penalties and Enforcement Process* in Coping with United States Export Controls 1990, *supra* note 8 at 386.

## E. The Department of Commerce Should Provide for Rulemaking Procedures that will Maximize Public Input notwithstanding the Military and Foreign Affairs Exemption of the Administrative Procedure Act[332]

While the Export Administration Act has not been subject to the notice-and-comment requirements of the APA, the Congress has nonetheless added requirements in the statute for consultation with affected parties and solicitation of public views. This reflects Congress' view that notwithstanding the very significant military and foreign affairs functions served by the Export Administration Regulations, Commerce is to develop them in public view. Repeal of the APA exemption would make notice-and-comment rulemaking the rule for Commerce, requiring the department to defend its claimed exceptions.

Because Commerce already claims the broadest possible reach for the military and foreign affairs exception within the APA rulemaking requirements,[333] and because regulations implementing the EAA will inevitably have some military or foreign affairs implications, Congress should maintain section 13(b) of the EAA calling for maximum public input[334] and the other provisions mandating consultation.[335] This recommendation is consistent with that of the National Academy of Sciences on this point.[336]

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[332] The final recommendation of the Judicial Review Committee of the Administrative Conference provides:

> "V. Rulemaking. A.) Although the military and foreign affairs exemption of section 553 of the APA will be available to the Department of Commerce for some of its rulemaking under the Export Administration Act, the Conference supports the recent recommendation of the National Academy of Sciences that Congress should retain section 13(b) of the Export Administration Act. That section, which exhorts the Department to provide "meaningful opportunity for public comment" in departmental rulemakings "to the extent practicable," plainly expresses a congressional understanding that not all departmental rulemaking falls within the appropriate bounds of the military and foreign affairs exemption, and thus appropriately encourages the Department to exercise restraint in its application.
>
> B.) To the extent feasible, the Department of Commerce should treat foreign availability determinations under sections 5(f)(1) and 5(f)(2) of the Export Administration Act as rulemaking within the terms of section 553 of the APA. Where, for reasons of time or other considerations, such determinations must be made in the context of decisions on individual license applications, the Department should publish the determination made with an invitation for public comment respecting related future determinations.

[333] *See, e.g.* 55 Fed. Reg. 46, 503, 46,504 (1990) *Elimination of Submission Requirements for Certain Supporting Documents* ("The provisions of the Administrative Procedure Act, 5 U.S.C. 553, requiring notice of proposed rulemaking, the opportunity for public participation, and a delay in the effective date, are inapplicable because this regulation involves a foreign and military affairs function.") The rule related to what documents an exporter had to submit and/or retain to evidence compliance with the regulations.

[334] 50 U.S.C.A. app. §2412(b) (West supp. 1990).

It should be generally clear under the EAA which types of decision-making processes are rulemaking and which constitute adjudication. However, the procedure relating to foreign availability determinations are a blend of both.[337] While exporters can raise the foreign availability issue in a license application, the nature of the inquiry in determining foreign availability makes the process more closely resemble rulemaking. Because the outcome of the decision is of broad public interest involving a range of external factors, foreign availability determinations are better suited to be handled as rulemaking decisions to the extent they can be consistent with statutory deadlines for license decisions.

While the Department of Commerce makes reasonable efforts to solicit public input on its implementing regulations, the mandate of the APA will give great impetus for expansion of those efforts. With the addition of meaningful judicial review, the rulemaking process at the department should become substantially more responsive to concerns of Congress and the regulated public.

## VIII. Conclusion

The United States and the other technologically advanced nations of the world continue to have an interest in preventing certain foreign states access to advanced technology. Our recent experience with Iraq vividly illustrates this point. The United States government will continue to require a system for controlling American exports in support of national and global security concerns and foreign policy objectives. But the Cold War era national security arguments that propelled the current system of controls are being reexamined, and the arbitrary and unreviewable procedures implementing these controls must also be reexamined.

The primary premise of the recommendations accompanying this report is that regulation explained and exposed to outside scrutiny is likely to be sounder regulation. The Export Administration Act blends economic regulation, foreign policy decisions, and national security classified information in a complicated system of trade controls that has a dramatic effect on United States foreign trade. The recommendations attempt to take that blend into account while offering ways to provide American exporters the kind of administrative due process and fundamental fairness they have come to expect in our system of governmental regulation of business.

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[335] *See* notes 208-24 *supra* and accompanying text.

[336] NAS Study, *supra* note 1 at 193.

[337] 55 Fed. Reg. 32,899 (1990). *See* text accompanying notes 157-71 *supra*.

## Report for Recommendation 91-3

# The Social Security Administration's Representative Payee Program: Problems in Administrative Paternalism

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This report was prepared for the consideration of the Administrative Conference of the United States. The views expressed are those of the author and do not necessarily reflect those of the members of the Conference or its committees except where formal recommendations of the Conference are cited.

# I. Introduction

## A. Overview

To prevent certain social security beneficiaries from squandering their benefits and to protect them from exploitation by others, Congress has authorized the Social Security Administration (SSA) to pay such persons' benefits to friends, relatives or some other person or organization to be expended on their behalf.[1] The resulting "representative payee program" currently pays about $20 billion in social security benefits to representatives of more than 4 million Americans, providing them, in most instances, welcome relief from the burdens of managing their day-to-day financial affairs. Yet, like other examples of government paternalism, the representative payee program limits individual rights (in this case, a beneficiary's right to control the expenditure of federal benefits), with or without consent, in order to provide assistance and protection.[2] Because discretionary authority has been granted to an administrative agency to balance these often conflicting interests in individual liberty and property, because the agency's discretion is almost unlimited by the Constitution, the Social Security Act or the Administrative Procedure Act, and because the number of persons affected by the representative payee program is already large and growing, the adjudication of their interests by SSA presents serious "mass justice" issues concerning the agency's ability to affect individual interests accurately, fairly and wisely.[3] Resolution of these issues may well establish principles that will shape future paternalistic efforts by the federal government, including those of the other federal payment programs that utilize the representative payee mechanism.[4]

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[1] Social Security Act Amendments of 1939, ch. 666, §205(j)(1), 53 Stat. 1371 as amended by Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, §5105, 149 Cong. Rec. H. 12,497 - 501 [hereinafter OBRA 1990] (to be codified in 42 U.S.C. §405(j)(1) (hereinafter referred to as section 205(j)) pertaining to benefits paid under Title II of the Social Security Act states:

> If the Secretary determines that the interest of any individual under this title would be served thereby, certification of payment of such individual's benefit under this title may be made, regardless of the legal competency or incompetency of the individual, either for direct payment to the individual, or for his or her use and benefit, to another individual, or an organization.

Section 1631 of the Social Security Act as amended by OBRA 1990 (to be codified as 42 U.S.C. §1383(a)(2)(A)) (hereinafter referred to as §1631) pertaining to benefits payable under Title XVI of the Social Security Act states:

> (i) Payments of the benefit of any individual may be made to any such individual or to the eligible spouse (if any) of such individual or partly to each.
>
> (ii) Upon a determination by the Secretary that the interest of such individaul would be served thereby, or in the case of eligible spouse referred to in section 1611(e)(3)(A), such payments shall be made, regardless of the legal competency or incompetency of the individual or eligible spouse, to another individual or an organization...for the use and benefit of the individual or eligible spouse.

Congress has recently enacted two pieces of legislation relevant to the resolution of the problems posed by the broad discretion granted to the Secretary of HSS to administer the representative payee program. In one, Congress amended the Social Security Act dealing directly with specific, selected administrative issues involved in representative payment, while leaving other, more fundamental issues unaddressed.[5] In the other, the Negotiated Rulemaking Act of 1990, Congress established a mechanism for promulgating agency rules through the participation of persons and organizations with interests affected by the rulemaking.[6] It is the thesis of this study that the former legislative approach cannot be invoked consistently or effectively to structure the administration of a large, complex, dynamic program like representative payment. Rather, the proper use of legislative authority in this area would seem to be the establishment of basic policy objectives for the program--something Congress has failed to do. Instead of enacting detailed administrative procedures, Congress might have directed the agency to initiate negotiated rulemaking proceedings to establish administrative standards and procedures through consensus rules proposed by persons with interests affected by the program. Not only would such a process provide a more appropriate forum for refining policy objectives and procedures, it would provide legitimacy to the resulting administrative rules.

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[2] Unlike other examples of government restraint on conduct, such as helmet and seat belt laws, the limitations inherent in the representative payee program can be viewed as conditions on governmental largess--old age, disability and income assistance benefits--and therefore less an infringement of legally protected property and liberty interests. However, as social security benefits are conceived under the Act, beneficiaries who are subject to representative payment must be finally determined to be entitled to receive their benefits before certification payment to a representative payee is authorized. 42 U.S.C. §405(i) and (j). Subsection (i) provides "Upon final decision of the Secretary, or upon final judgment of any court of competent jurisdiction, that any person is entitled to any payment or payments under this subchapter, the Secretary shall certify [direct payment]...."

[3] Dixon, "The Welfare State and Mass Justice: A Warning from the Social Security Disability Program," 1972 DUKE L. J. 681 (1972). As discussed more fully below, the representative payee program presents questions about (1) prohibitions against and requirements for government action, (2) appropriate limitations--constitutional, statutory and policy--on agency discretion to restrict individual freedom in order to confer a government benefit, and (3) government's affirmative obligation to provide protection and services to individuals whose liberty it has so restricted. These issues may be resolved differently depending on the substantive purposes the Congress intended to achieve (e.g., assisting certain vulnerable beneficiaries, limiting government liabilities, ensuring the wise expenditure of taxes) and the goals of administrative procedure expressly or implicitly adopted to provide it legitimacy in accomplishing those purposes (e.g., accuracy, respect for dignity, consistency, accountability). Finally, these inquiries present questions about the institutional capacity of the states and the federal government (Congress, the courts and administrative agencies) to make the determinations constitutionally required to provide social security beneficiaries procedural due process of law in the adjudication of their liberty and property interest in expending their social security benefits.

[4] See discussion of representative payee programs of the Labor Department, Railroad Retirement Board, Office of Personnel Management and Veterans Affairs at notes 53-57 infra.

Although SSA is experienced in meeting demands for accuracy and fairness on a massive scale in the social security payment programs (particularly the disability program),[7] the representative payee program is not a payment program but a form of nonvoluntary assistance that presents issues not arising in the entitlement programs. First, unlike most other federally-provided benefits, there are no established criteria which, if met, will entitle a beneficiary to the assistance of a payee. The Secretary is simply authorized (but not required) to certify representative payment when he or she finds it in a beneficiary's interest. Furthermore, the government may impose representative payment on an unconsenting beneficiary. Thus, while entitlement to monetary benefits is not at issue in representative payee determinations, autonomy interests in controlling benefits, as well as self-esteem, standing in the community and the ability to function in society, often are. Third, the monetary benefits involved in representative payment determinations will be paid by the Secretary whether or not the beneficiary is found to need a representative payee. Unlike the entitlement programs, where eligibility determinations directly affect the public purse, the government's only financial interest in representative payment determinations is the minimization of administrative costs. Finally, SSA's determinations that beneficiaries are incapable of managing their affairs are much like determinations of incompetence made for guardianship and commitment purposes, which are traditionally made by the judiciary exercising state *parens patriae* powers rather than by a federal, administrative agency carrying out a Congressional exercise of spending power. In sum, representative payment is nonmonetary, protective assistance to which there is no entitlement, provided to social security recipients, with or without their consent, by a federal administrative agency, which supplements, and in some cases may supplant, state *parens patriae* power.

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[5] See H. R. Conf. Rep. No. 101-964 on H.R. 5835, 149-Part II CONG. REC. 12496-12501, 12683-12684 (Oct. 26, 1990) [OBRA 1990].

[6] Negotiated Rulemaking Act of 1990, Pub. L. No. 101-648, 104 Stat. 4969 (Nov. 29, 1990) (to be codified at 5 U.S.C. ___, 101 Cong. 2d. Sess., 149.

[7] See, e.g., J. Mashaw, *Bureaucratic Justice: Managing Social Security Disability Claims* 121 (1983); Koch and Koplow, "*The Fourth Bite at the Apple: A Study of the Operation and Utility of the Social Security Administration's Appeals Council*," 1987 ACUS 625 (1988) *reprinted in* 17 FLA ST. U. L. REV. 199 (1990); Bloch, "*Report and Recommendations on the Social Security Administration's Administrative Appeals*," Conference Consultant's Report (1989).

The representative payee program presents a rare opportunity to study administrative paternalism on the federal level. Representative payment is not paternalistic in the pejorative sense, but in its original, familial sense, of an authority providing assistance and protection to certain dependents. SSA can be viewed as a federal administrative agency struggling--with little guidance from Congress, the courts or its huge constituency--to use its broad discretion to reconcile competing interests in individual autonomy and social benevolence that are necessarily put in tension by its paternalistic mission. Thus, to the extent that the Secretary is authorized to make decisions about beneficiary interests, what expenditures benefit them, the need for a payee, and the terms of the payees' fiduciary obligations; and to the extent that Congress may have expected such decisions to be controlled by agency policy, decisions regarding the expenditure of federal benefits are to be centrally made by the agency rather than by individual beneficiaries or their representatives. A government that imposes assistance and protection involuntarily upon persons who do not appreciate the benefit of the aid provided (such as state civil commitment of incompetent people to mental institutions) has been termed a "therapeutic state." The therapeutic state differs from the "welfare state" in that the latter makes assistance (such as disability benefits) available only on a voluntary basis.[8] Representative payment can be viewed as one of only a few examples of the therapeutic state on the federal level.[9]

This study analyzes the program from a traditional perspective, which views interests in autonomy (and the underlying acceptance of moral relativism) and beneficence (and the underlying assumption of moral absolutism) as distinct and sometimes conflicting values.[10] An acceptance of the importance of one value over the other dictates the model of procedural fairness that is appropriate for resolving those conflicts. For example, if liberty interests in controlling the expenditure of benefits and individual autonomy are highly valued, an adversarial adjudication model is institutionally appropriate to protect those interests. On the other hand, if providing benefits to persons in need of assistance, with or without their concurrence, is highly valued, an almost medical model of therapeutic procedure, which relies heavily on unreviewed expertise, service and fiduciary responsibility, may be more appropriate. These different assessments of the relative value of individual autonomy and beneficence give rise to the separate approaches illustrated by two other legal mechanisms that provide financial management services to vulnerable people on a nonvoluntary basis--the rights approach exemplified by state guardianship proceedings and the benevolent approach illustrated by the Department of Veterans Affairs (VA) fiduciary program.

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[8] N. Kittrie, *The Right to be Different: Deviance and Enforced Therapy* (1971).

[9] Other examples would include the program of the Department of Veterans Affairs for incompetent recipients of VA benefits, discussed below, and some labor laws such as those that further the interests of minors who desire to work by prohibiting their employment.

Having been reformed by state legislatures in the last decade to conform to a legal, rather than a medical, model, state guardianship laws provide a wide array of adversarial, adjudicatory procedures to safeguard the individual liberty and property interests at stake. The veterans program, on the other hand, provides fewer procedural safeguards and only limited judicial review, but affirmatively strives to design and provide a variety of management services tailored to individual needs as the VA perceives them. An evaluation of SSA's representative payee program suggests that it conforms to neither model--it is not institutionally structured to provide either predetermination, full evidentiary hearing rights to protect liberty and property interests, or the social, management and monitoring services necessary to provide the assistance needed by vulnerable beneficiaries. However, a recommendation that SSA emulate one or the other model would depend on the value placed on interests in autonomy and benevolence. The agency has the discretion to make that choice.

Congress has provided the agency little guidance as to which interests it values most highly, either in the express terms of the statute or through other indications of its underlying policy objectives. While assisting beneficiaries is representative payment's primary objective, Congress may have intended to accomplish that objective by several means--by appointing surrogates to carry out the preferences of incapable beneficiaries; by appointing fiduciaries to expend funds in a manner they determine to be in the best interest of beneficiaries; or by assuring the expenditure of federal funds in socially acceptable ways. Nor does the Constitution significantly limit SSA's authority. The Constitution, according to accepted constitutional due process doctrine, permits the agency broad discretion to choose between these competing values. The *Mathews v. Eldridge* cost-benefit analysis, requires only that the agency use procedures conducive to producing accurate applications of law to facts and that benefit affected private interests at least as much as they burden the government. As often noted, these due process boundaries are difficult, if not impossible, for courts to discern,[11] and do little to restrain or direct the value judgments made by the agency in its policymaking role. Procedures that promote accurate decisionmaking do not limit agency policymaking. Indeed, there are many who would argue that this is entirely appropriate--that the courts, unaccountable and having no claim to intuitive infallibility, should not use constitutional interpretation to make such policy choices, but should leave them to the discretion of the agency to which Congress, acting as agent of the people, has committed them.

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[10] Lowi, "Liberal and Conservative Theories of Regulation," *The Constitution and The Regulatory State* 7 (Bryner and Thompson, eds. 1988). Although sometimes used interchangeably in this article, the term "autonomy" is used to mean independent, self-controlled or self-governed thought and behavior, especially moral independence. "Liberty" is used to mean autonomy legally protected from interferences by the state, and "freedom" to mean autonomous thought and action without external restraint. "Beneficience" is used to mean the intention to "bring about good in the lives of other persons for their sake." See Sorensen, "Freedom and Regulation in a Free Society," *Id.* at 67, 70

However, the absence of Congressional guidance and constitutional restraints raises serious questions about why such unrestrained administrative disretion should be given legal effect. The "transmission belt" theory of legitimacy, based on the transfer of directed policy making authority to agencies, breaks down where choices between competing social theories are left to nonelected officials without statutory directives against which courts can measure the limits of their authority.[12] Nor does a theory of legitimacy based on agency expertise wholly support the delegation to SSA of basic policy choices regarding representative payment, since the decision whether to value autonomy over benevolence can be informed by expertise but not determined by it. Value judgments are based not on the empiricism associated with professional acumen, but on moral conviction.

This study suggests that administrative legitimacy may be founded on the process by which policy is formulated rather than on the choice made between competing social values. In sum, representative payment can be viewed, not just in terms of opposing dichotomies--public and private interests; liberty and benevolence; the individual and society; moral relativism and moral absolutism--but in an associational context, as a part of a complex network of interdependent relationships that define both autonomy and benefit for individuals in accordance with social, economic and political position. To the extent that government requires administrative agencies to establish rules, standards and procedures to make its actions affecting such relationships predictable and at least indirectly accountable to the electorate, the rules may gain legitimacy when they are born of the relationships of which they will become a part. Legitimacy of administrative action premised on participation of affected interests need not be limited, as it has been in this context, to participation in administrative adjudication,[13] but can be extended through negotiated rulemaking procedures to its policy formulating, rulemaking functions as well.

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[11] See *e.g.*, Mashaw, *Due Process in the Administrative State*, 102-157 (1985).

[12] Stewart, "*The Reformation of American Administrative Law*," 88 HARV. L. REV. 1667, 1671 - 1679 (1975).

Participation by affected persons or their representatives, along with the agency, in development of standards and administrative procedures governing the relationships between them may justify judicial deference, even in constitutional adjudication, to the value preferences expressed such in administrative rulemaking. Procedural rules promulgated through such a participatory process should be weighed differently in the *Mathews v. Eldridge* calculus than those produced by the agency alone, and deference might well be paid to a process institutionally better suited than the judicial process to defining, valuing and weighing affected interests of beneficiaries and the government and ascertaining the value of proposed procedures to the effectuation of those interests. The solution of mass justice issues, then, may lie in a process for developing procedures viewed as just (or at least accepted as an expedient approximation thereof) by those whose relationships will be affected.

Thus, this study recommends that SSA initiate negotiated rulemaking, in accordance with the procedures enacted by Congress, to establish standards and procedures for determining the need for representative payment and the selection and monitoring of payees. The ultimate object of both individual autonomy and beneficence in the context of the representative payee program is to promote the best interests of the individual, although the power or authority to determine that interest is differently placed by partisans of the two positions and each would take different means to that end. Nevertheless, this shared objective and its commitment by Congress to an administrative forum may provide a basis for negotiating appropriate procedures for its attainment. Such procedures would be legitimated by the participatory process by which they are promulgated, rather than by an assessment of the resulting substantive value judgments they embody.

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[13] Stewart and Sunstein, "Public Programs and Private Rights," 95 HARV. L. REV. 1193 (1982).

## B. Current Administration and Concerns

Although representative payment implicates personal liberty interests rather than monetary interests, the procedures SSA currently uses to administer the representative payee program are similar to those used to determine eligibility for the cash payment programs (such as the disability program) it administers. SSA determines a beneficiary's eligibility to have a payee appointed to receive benefits in accordance with certain findings. Although the statute authorizes the Secretary to make direct or representative payment regardless of the beneficiary's legal competence, the Secretary has issued regulations requiring payment to a representative payee for most children and most adult beneficiaries determined incompetent by a state court. In addition, representative payment will be ordered for beneficiaries judged by a physician or found by an SSA claims representative on the basis of lay evidence to be incapable of managing or directing the management of their financial affairs.[14] Finally, Congress has required that all supplemental security income (SSI) beneficiaries who qualify for payment on the basis of a disability determination supported by a finding of drug or alcohol abuse must receive representative payment. Consequently, while most beneficiaries determined legally incompetent by state courts are provided representative payees, many others are also determined by the Secretary to be in need of representative payment.

Under current SSA regulations, after a beneficiary has been determined to be incapable of managing or directing the use of his or her benefits and a payee has been selected, SSA gives the beneficiary "advance notice" of its determination and provides the beneficiary a period of time within which to review the evidence, provide additional evidence and "protest" the determination before it is put into effect. If, after protest, a claims representative confirms the incapability determination, it is regarded as an "initial determination," which is implemented immediately, and the beneficiary receives a "formal notice" of the action. The initial determination may be reviewed by a claims representative through a request for "reconsideration" and appealed for a de novo review by an administrative law judge, with a right to an administrative appeal to the SSA Appeals Council and a judicial review pursuant to provisions of the Social Security Act. The agency has not yet revised its procedures to reflect the 1990 amendments to the Social Security Act. As discussed below, these amendments may require the agency to afford beneficiaries a hearing before representative payment is made.[15]

The payees appointed by SSA are most often friends or relatives of the beneficiary. They often initiate the agency's determination and are found by the agency to be suitable payees. If no suitable payee can be found, SSA may suspend the payment of benefits to the beneficiary altogether for up to 1 month or until a payee is appointed in some cases; a lump sum payment of the back benefits will then be made to the newly appointed payee. All payees are required to account to the agency annually, by filing a one-page form indicating how they have expended funds in the beneficiary's interest. Payees found by SSA to have misused benefits are always requested to refund misused funds, but are only infrequently required to pay restitution through civil proceedings or prosecuted criminally. Where the agency believes that there may have been negligent investigation or appointment of a payee, it may repay misused funds to the beneficiary or a subsequently appointed payee.

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[14] See discussion at notes 119-128 infra.

[15] See discussion at notes 217 to 218 *infra*.

SSA administered the representative payee program with little public notice or criticism for almost half a century. However, in recent years, beneficiaries' rights to fair determinations of need for a representative payee, to selection of appropriate payees and to adequate monitoring of payee performance, have been hotly debated in both legislative and judicial forums. After several lawsuits and some dramatic examples of payee abuse received notoriety in 1988 and 1989, Congress, SSA, the media and others became concerned about several aspects of the program.[16] SSA convened an intraagency Representative Payment Task Force in September 1988. Newspapers reported that a California woman previously convicted of social security fraud was indicted for the murder of eight social security beneficiaries residing in her board and care home, one of whom was a beneficiary for whom she had been appointed payee. In another case, the United States District Court in Colorado ordered SSA to compensate a beneficiary whose $7,945 lump sum disability benefits were stolen by a representative payee whose criminal background the agency failed to investigate.[17] A United States Court of Appeals let stand a district court ruling that SSA's failure to require payees to account for benefits they administered violated beneficiaries'constitutional rights.[18] A California court found that "a grim image of homelessness and hunger" and extortion by aspiring "trustees" resulted from SSA's suspending benefits when it could not find suitable payees.[19] And, public administrators have voiced the fear that unscrupulous family members ask to be made representative payee for older relatives to get social security checks averaging $400 to $500 a month, and use the majority of funds to finance their drug and alcohol addictions.[20]

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[16] See, e.g., SSA's Representative Payee Program: Safeguarding Beneficiaries From Abuse, Hearings Before the Special Committee on Aging, United States Senate, 101st. Cong. 1st. Sess., S. Hrg. No. 101-182 (June 6, 1989).

[17] Holt v. Bowen, 712 F. Supp. 813 (D. Colo. 1989).

[18] Jordon v. Bowen, 808 F.2d 733 (10th Cir. 1987).

[19] Briggs v. Sullivan, 886 F.2d 1132 (9th Cir. 1989).

Although clearly isolated incidents, these anecdotes have caused concern that determinations of the interests of beneficiaries may not be made to the benefit of many social security recipients; that too many unqualified payees may go undetected by SSA; that incapable beneficiaries are harmed when SSA temporarily suspends payments because suitable payees are unavailable; that payee use of funds has not been adequately monitored; and that payees who misuse benefits are not pursued nor the victims of their misuse made whole.

## C. This Study

The Administrative Conference of the United States (ACUS) was asked by SSA to study these problems and make recommendations for improving its program. This study describes SSA's current practices affecting representative payment, examines the legal and administrative issues they present, and suggests ways in which the administrative process used by SSA in the representative payee program might be changed to accomplish its various goals.

Following a discussion of the current SSA representative payee program and other similar programs, the study is divided into four sections that examine: (1) the standards used to determine whether a social security beneficiary needs a representative payee; (2) the administrative process by which SSA makes that determination; (3) the standards and procedures by which SSA investigates and selects a representative payee ; and (4) the ways in which SSA monitors the performance of representative payees and holds them accountable for acting in the beneficiary's interests. The administrative law issues raised by this process are framed in terms of the agency's responsibility under the Constitution, its organic Act, and the Administrative Procedure Act (APA) to (1) promulgate standards to guide the agency's discretion in establishing standards in these four areas; (2) afford certain procedural rights to persons affected by its determinations, and (3) enforce or carry out its determinations. In the course of examining SSA's standards, procedures and enforcement efforts, this report compares SSA's practices with those used for similar purposes by the Veteran's Administration (now renamed the Department of Veterans Affairs and hereafter called the VA) and state guardianship authorities.

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[20] Testimony of Stuart White, Legislative Director, Michigan Office of Services to the Aging, before the Subcommittee on Social Security, the Ways and Means Committee, United States House of Representatives, March 22, 1989.

The study concludes that any restraints arising from the nondelegation doctrine, the vagueness doctrine, the due process clause, the Social Security Act and the Administrative Procedure Act permit SSA considerable latitude in establishing and applying standards of incapability to beneficiaries for payment purposes, in selecting payees, and in determining misuse by payees. However, SSA requires help in establishing an administrative process that reflects a legitimate choice between the fundamental interests inherently in tension in the program.[21] SSA's current procedures may, on the one hand, be wasteful of the agency's time and money by determining that too many beneficiaries are in need of payees, and, on the other, they seem to provide insufficient assistance and protection for those beneficiaries who do need payees. The study suggests that Congress consider carefully the implications of continuing this exercise of paternalistic authority on the federal level, rather than deferring to state guardianship and social service programs to protect vulnerable social security beneficiaries. If the federal program is to be continued, the agency should consider initiating informal negotiated rulemaking to develop standards and procedures for determinations of need, selection of payees, and monitoring of their performance. Such a participatory process for the formulation of rules governing representative payment should produce rules that better meet beneficiary needs (as they are articulated and evaluated by individuals and groups representing those interests), and provide legitimacy to the administrative policy determinations that must be made to reconcile social interests in autonomy and beneficence.[22]

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[21] In addition to the APA requirements for informal rulemaking and legislative standards to guide agency discretion, discussed below, commentators analyzing administrative process in different contexts have posited a number of objectives, or goals of administrative law, that may counsel additional procedures as a matter of sound administrative policy. See, e.g., J. Mashaw, *Due Process and the Administrative State*, 121-57 (1985). Thus, one model of administrative justice is based on sets of legislative and judicially created criteria which give the process legitimacy. This model of conventional administrative due process was the one most often discussed in legal opinions and scholarly comment before the advent of an era of due process adjudication commencing with *Goldberg v. Kelly* and *Mathews v. Eldridge*. After *Eldridge*, courts sought to determine requirements for administrative justice by weighing the participants' and the government's interests and the likelihood of error in the absence of contested procedures. This model of justice, which promotes accuracy and efficiency, has been criticized as requiring information not available to the judiciary, or perhaps at all, about the likelihood of error and requiring impossible valuations and projections of the interests of the parties and for ignoring other important values such as respect for personal dignity. *Id.* See also Rubin, "Due Process and the Administrative State," 72 CALIF. L. REV. 1004 (1984) and Searchinger, "The Procedural Due Process Approach to Administrative Discretion: The Courts' Inverted Analysis," 95 YALE L. J. 657 (1988).

[22] Some of the major goals have been recognized to be: accurate determinations, efficient and cost-effective procedures, and decisions that comport with accepted notions of fairness,

In the absence of such a participatory process, recommendations are made for various changes in SSA procedures to better meet statutory and administrative goals. The study recommends that the agency establish a functional definition of incapability to be applied by specially trained SSA personnel after notice and a face-to-face interview with the beneficiary; that benefits not be suspended while appropriate payees are being sought, even if SSA must temporarily act as payee; and that more efficient and effective monitoring and accounting procedures be established for payees. The study was conducted over a 5-month period in late 1989 and early 1990 and included personal interviews with interested persons and representatives of the agency and interested groups, as well as an examination of legal and administrative materials. The author is especially grateful to the many SSA personnel who were cooperative and informative throughout the study.

## II. The Representative Payment Program

### A. Dual Nature of the Social Security Program

The representative payee program can best be understood in the context of the larger social security programs of which it is a part. The Social Security Act provides both insurance benefits and assistance payments to more than 40 million Americans. Title II provides insurance benefits to the aged, the disabled and their dependents and survivors who have purchased it through mandatory payroll deductions during their working years.[23] Title XVI also

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equity, and individual dignity. There has been increasing recognition that administrative process designed to promote efficient and accurate decisionmaking does not fully meet the demands for justice that are made upon administrative systems. Thus, recent efforts have been made to evaluate the administrative process in terms of its ability to meet the dignitary interests of participants as well the other traditional goals of fairness, efficiency and accuracy. J. Mashaw, Due Process in the Administrative State 158-238 (1985); L. Tribe, American Constitutional Law 744 (2d ed. 1988); Michelman, "Formal and Associational Aims in Procedural Due Process," Due Process NOMOS: XVII 126-128 (1977).

[23] Beginning in 1939, Title II of the Social Security Act provided monthly benefits to retired workers and their dependents (usually spouses and children) and to their survivors. Since 1960, it has also provided monthly benefits to disabled social security taxpayers who become permanently and totally disabled. See generally, House Comm. on Ways and Means, 101st Cong. 1st Sess., *Background Material and Data on Programs Within the Jurisdiction of the Committee on Ways and Means*, 3-8,41-59 (1989)(Background Material). Workers are compelled under the Federal Insurance Contribution Act (FICA) to contribute to the social security trust fund through employer matched payroll and self-employment taxes during their working years. Chapters 2 and

provides income assistance to some of the nation's neediest persons.[24] The Secretary is authorized to make representative payment to both types of beneficiaries. In 1939, 4 years after the Social Security program for retired workers was passed, Congress amended the program to authorize SSA to make benefit payments to someone other than the beneficiary "when it appears to the Secretary that the interest of an applicant entitled to a payment would be served thereby" "regardless of the legal competency or incompetency of the individual entitled thereto."[25] Thus, the Secretary has broad discretion to make either direct or representative payment to legally competent and legally incompetent beneficiaries of old age, survivors and disability insurance. Similar authority was granted to the Secretary in 1972 with regard to the payment of supplemental security income assistance.[26] The legal authority of the Secretary to appoint a payee to expend Title II and Title XVI benefits has been characterized as:

> [an] intricate, even confusing, lattice of statutes, regulations and procedures [in which] there is an extra level of

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21 of the Internal Revenue Code. When they retire, die or become disabled, monthly cash benefits are paid under Title II as a matter of earned right or entitlement to those workers who are insured for benefits and to their eligible dependents and survivors. In December 1988, there were 38.6 million beneficiaries receiving the old age, survivors and disability insurance payments under Title II totalling $18.7 billion. Background Material, supra, at 3-4. The average monthly payment for an individual retired worker in 1988 was $501. Social Security Administration, 1989 Annual Report to the Congress (1989).

[24] The Supplemental Security Income (SSI) program is a federal program established in 1972 to provide monthly income assistance payments to persons determined to be needy in accordance with federally established eligibility criteria or benefit standards. Background Material, supra, at 671-673. To become eligible, a person must be 65 years of age or older, or be blind or disabled and have an income and resources below certain benefit standards. The regular federal SSI benefit standard for an individual for 1988 was $355 a month and is indexed to the Consumer Price Index (CPI). In addition, to be eligible for SSI payments, an individual may not have assets of more than $2,000, excluding certain assets such as the individual's home, household goods, a car and burial space. Thus, there can be overlapping eligibility under the Act. For instance, a person may be receiving old age insurance under Title II, but have so little income that he or she qualifies for old age income assistance payments under SSI. All but eight states and jurisdictions supplement the federal benefit standard to establish a combined state-federal standard against which eligibility is measured. In 1989 these state supplementations varied from none to $384 per month (in Connecticut) and supplemented the federal payment to about 42 percent of the nation's SSI recipients. Background Material, supra, at 679-680. Seventeen states have elected to contract with SSA to administer their supplementary payments.

[25] The relevant authority granted to the Secretary of Health and Human Services is found in Sections 205(j) and 1631 of the Social Security Act (42 U.S.C.§405(j), and §1383(a)(2)(A))(1990).

[26] 42 U.S.C. §1383(a)(2)(A)(i)(ii) (1988).

> complexity, for there are two separate statutory schemes, with different criteria governing payment to someone other than the beneficiary (representative payment in the parlance of the Secretary). . . . [27]

The dual nature of the Social Security Act--an insurance program and a welfare program--colors the debate about the propriety of limiting individual control over the benefits it provides through the representative payee program. Persons who have earned insurance benefits through their payments during working years may make greater claims to procedural and substantive protection than persons who have become dependent upon the state for maintenance by virtue of their inability or failure to "purchase" such insurance through work.[28] On the other hand, the Supreme Court has weighed the interests of welfare recipients more heavily than those of beneficiaries of the insurance programs in determining the procedural due process to which each is entitled.[29] Thus, the representative payee program needs to be understood in the context of the larger social security program of which it is a part. Whether this distinction should find expression in the representative payee program depends upon the purposes the program is intended to accomplish. As discussed below, there are at least three general goals representative payment might further--assistance to vulnerable beneficiaries, responsible expenditure of federally provided benefits, and protection of the autonomy interests of beneficiaries.[30]

Provisions of the Act pertaining to representative payment have been amended with increasing frequency in the last decade. The statutory basis for the representative payee program did not change from its beginning in 1939 until 1972 when the Secretary was given authority to appoint representative payees for SSI beneficiaries and required to appoint payees for SSI beneficiaries who had been found to be disabled due to drug or alcohol addiction. As discussed more fully below, Congress again amended the Social Security Act in 1984 to require SSA to investigate the trustworthiness and qualifications of persons applying to be appointed representative payees and to monitor their performance. These amendments were in part a response to beneficiaries to receive benefits when payees could not be found, accountings of the benefits received and administered by payees, and repayment of benefits by SSA when SSA fails to properly investigate and monitor payees.

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[27] Briggs v. Sullivan, 886 F.2d 1132, 1134 (9th Cir. 1989).

[28] This kind of "rights" "privilege" distinction with regard to government entitlements has, however, been rejected in other contexts (e.g., the demise of the constitutional condition doctrine).

[29] Thus, the Court weighed more heavily the interests of welfare beneficiaries who would be "destitute" without funds (*Goldberg v. Kelly*, 397 U.S. 254,261 (1969)) than the interests of disability beneficiaries whose eligibility for benefits does not depend on financial need (*Mathews v. Eldridge*, 424 U.S.319,340 (1975))

[30] See discussion at notes 154-163 *infra*.

## B. Facts and Figures About the Representative Payee Program

More than 4-1/2 million beneficiaries, or about 10 percent of all social security beneficiaries, receive their benefits through a representative payee--about half of these are adults. [31] In 1989, of the 39 million people receiving Title II benefits, 3,334,312 or approximately 8.54 percent were in representative payment.[32] Of the 4.6 million receiving SSI payments, 1,177,188 or approximately 25.6 percent were in representative payment.[33] Thus, a total of 4,511,500 or more than 10 percent of all 43.6 million social security beneficiaries receive benefits through a representative payee appointed by SSA.

It is estimated that about 10.5 percent of the total $242 billion paid in social security benefits, was paid to representative payees in 1987.[34] In 1989, all beneficiaries entitled to old age and survivors insurance under Title II received a total of $205.3 billion in payments and those entitled to disability insurance received $22.7 billion. The average monthly payment to a retired worker was $537 and to a disabled worker was $530.[35] If those in representative payment received a proportional share of all benefits, $20 billion was paid by SSA to representative payees for old age survivor and disability insurance beneficiaries in 1989.[36] These figures would indicate that an estimated $20 billion was paid to representative payees for Title II benefits in 1989.

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[31] In 1989, a total of 34.9 million retired workers and family members received old age and survivor benefits and 1.4 million workers and family members received disability insurance under Title II of the Act; there were also million who received old age assistance and 3.1 million who received assistance to the blind and disabled under the SSI program--for a total of million people who received benefits from the SSA. Social Security Administration, 1990 Annual Report to the Congress (1990). In 1988 there were 23.8 million retired workers, apart from family members and dependents, receiving old age and survivors benefits and 2.8 million workers receiving disability insurance under Title II for a total of 26.6 million. Social Security Administration, 1989 Annual Report to Congress, 28 (1989). There were 393,837 beneficiaries entitled to both Title II and Title XVI benefits. *Id.* at 32.

[32] Of these, approximately one-third are adults and two-thirds are children under 18 years old.

[33] *Id.* Of these, approximately two-thirds are adults and one-third are children, excluding those who are also receiving benefits under Title II.

[34] Figures for the amount of benefits paid to representataive payees were not provided to Congress in SSA's 1989 and 1990 reports.

[35] *Id.* The average monthly payment to a retired worker and aged spouse was $917 and to a disabled worker, spouse and two or more children was $938. *Id.* at 24.

Federal and state SSI payments to beneficiaries of old age assistance totaled $3.2 billion in 1989 and SSI payments to the blind and disabled totaled $11 billion, for total SSI payments of $14.2 billion.[37] If beneficiaries in representative payment received a proportional share of all benefits, SSA paid $5.5 billion to representative payees for SSI beneficiaries. Thus, the total of all SSA payments to representative payees under Titles II and XVI was an estimated $25.5 billion in 1989.

These figures represent a significant increase in the use of representative payees in the last decade. In 1973, only 2.93 percent of all adult Title II beneficiaries had payees. The portion of adult beneficiaries determined incapable of managing their affairs increased in 1985 to 3.26 percent of all adult beneficiaries. Similarly, the number of adult SSI beneficiaries with representative payees increased from 9.17 percent to 19.49 percent from 1975 to 1983.[38] Comparable data is not available for all beneficiaries--adults and children.

Most beneficiaries in representative payment are children. Less than half, or only 1.9 million of the 4.3 million beneficiaries paid through a payee in 1988 were adults. SSA data indicate that a large percentage, 34 percent, of Title II beneficiaries who have representative payees are over 65 years old.[39] Many of these are older women. In 1985, women over 65 years old represented more than 25 percent of all adult Title II beneficiaries with representative payees. However, older women and older adults do not constitute as large a portion of SSI beneficiaries for whom representative payees have been appointed. In 1987, only 13 percent of all SSI beneficiaries with representative payees were over 65 years old.[40] In 1988, only 10 percent were over 65 years old.[41] Many are younger, disabled people. More than a third of all SSA beneficiaries with representative payees are institutionalized; most of them receive payments under Title II. [42]

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[36] *Id.* at

[37] *Id.* at 31.

[38] Surrogate Decisionmaking for Adults: Model Standards to Ensure Quality Guardianship and Representative Payeeship Services, Report Presented by Chairman of Subcommittee on Housing and Consumer Interests of the Select Committee on Aging of the House of Representatives, Comm. Pub. No. 100-75, 100th Cong. 2d Sess. at One-15, fn. 14 (1988). (hereafter Surrogate Decisionmaking) Letter of Dorcas Hardy, Commissioner of Social Security, to the Honorable Don Bonker, Select Comm. on Aging, U.S. House of Rep. p.1, tab A (Sept. 2, 1988).

[39] Social Security Administration, "Beneficiaries With Representative Payees - 12/88" (Aug. 1989).

[40] *Id.* and letter of Dorcas Hardy, *supra* note 37 at tab B.

Recently SSA has begun to collect (but has not refined) data about the number of payees serving SSA beneficiaries, the length of time they serve on average, their relationship to the beneficiary, the reasons for termination of payees status and the incidence of payee misfeasance. Most payees are relatives or friends, but about a quarter of all beneficiaries with payees have an institution or public official serving as payee. Residential institutions, such as nursing homes, retardation facilities, board and care facilities and mental hospitals, social service agencies or public officials were appointed payees for 345,000, or 26 percent, of adult Title II beneficiaries with payees and 207,000, or 34 percent, of adult SSI beneficiaries with payees.[43] Somewhat surprisingly, only a small portion of the adult beneficiaries determined by SSA to be incapable of handling their own affairs have been determined legally incompetent in a state court proceeding; these would have a court-appointed guardian or conservator. Of the 1.9 million adult beneficiaries reported by SSA to be in representative payment in December 1988, only 169,000 or 8.9 percent had been determined legally incompetent--141,000 of whom received Title II benefits and 28,000 of whom received Title XVI benefits.[44]

Although Congress has seen the need for representative payment since the late 1930s, the need has increased over the years and will continue to do so for several reasons.[45] First, an increasing portion of the nation's population is over the age of 65 and, therefore, at an age when physical and mental infirmities are more likely to make financial management difficult. Although the population as a whole increased 11 percent in the 1970s, the over-65 population increased 28 percent, to almost 30 million people, or 12 percent of the present population. It is estimated that by 2050, the over-65 population will comprise 22 percent of the population, or 67 million people.[46] In addition, the portion of the elderly who are 85 and older has increased even more dramatically--in the 1970s their numbers increased 59 percent. The likelihood that they will need help in managing their financial affairs is even greater.[47]

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[41] *Id.*

[42] *Id.* While, in 1988, 39 percent of all Title II beneficiaries with representative payees are institutionalized, only 22 percent of SSI beneficiaries with representative payees are institutionalized.

[43] *Id.* Social Security Administration, 1989. Report to Congress (1989). The SSA reported 1.3 million adult Title II beneficiaries in 1988 and 0.6 million adult SSI beneficiaries.

[44] *Id.*

[45] See generally, Surrogate Decisionmaking *supra* note 37.

[46] U.S. Senate Special Committee on Aging, Aging America - Trends and Projections: 1987-1988 Edition. U.S. Dept. of Health and Human Services LR3377 (1988).

Second, many mentally ill and mentally retarded people, both elderly and nonelderly, who formerly were maintained in institutions have been returned to the community.[48] When placed in a community setting, many need sheltered living arrangements, vocational training, and help in managing the routines of daily living, including management of social security and disability benefits. Because there are seldom sufficient community support services to serve them, deinstitutionalized people are often left to shift for themselves or become dependent on families unable to assist them. They are often vulnerable to both physical and financial exploitation.[49]

Finally, as noted in a report of the Housing and Consumer Interests Subcommittee of the House Select Committee on Aging, nursing homes increasingly are conditioning admission on the imposition of a guardianship or other surrogate decisionmaking arrangement such as the appointment of a trustee, representative payee, or attorney-in-fact or guardian, so that the nursing home can deal directly with family members or financial institutions rather than residents.[50] These arrangements are instigated to facilitate transactions and avoid liability rather than to meet the needs of the proposed ward.[51]

## III. Other Legal Mechanisms for Limiting Incapable Beneficiaries' Control Over Government Benefits

The SSA representative payee program can be viewed as one point along a spectrum of legal mechanisms for protecting the funds and interests of persons determined to be incapable of managing their own affairs. At one end of the spectrum are the least restrictive legal measures--ones that people can take while they are competent either to control the disposition of their affairs upon incompetency or to appoint a surrogate decisionmaker to assume responsibility under those circumstances. Among such mechanisms are living trusts and durable powers of attorney. At the other end of the spectrum are guardianship and involuntary commitment, with their major deprivations of liberty. States, exercising their *parens patriae* powers through the courts, may place the personal and financial affairs of an incompetent person in the hands of a guardian or conservator charged with a duty to act in their ward's best interest.[52] Such a court-appointed fiduciary has broad powers and responsibilities to care for such persons and administer their financial affairs.

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[47] *Id.*

[48] See generally, Talbot, "A Special Population: The Elderly Deinstitutionalized Chronically Mentally Ill Population," 55 PSYCHIATRIC QUARTERLY 90 (1983).

[49] For this reason, many states have passed adult abuse reporting statutes which require physicians and other professionals to report to public agencies suspected incidents of physical abuse, neglect and even self-neglect to public agencies which provide emergency protective services including guardianship and payee services in some cases. See generally, W. Schmidt, K. Miller, W. Bell and B. News, *Public Guardianship and the Elderly* 7-18 (1982)

[50] Surrogate Decisionmaking One-15 and One-16 (1988).

[51] See Frolik, "Plenary Guardianship: An Analysis, A Critique and a Proposal for Reform," 23 ARIZ. L. REV. 599, 625 (1981), noting the coincidence of physical relocation of unconsenting adults and the institution of guardianship proceedings.

In the middle ground are lesser measures, such as withholding driver's licenses from persons with physical or active mental disabilities. In the middle ground, too, is SSA's representative payee program, as well as the payee programs of VA, the Office of Personnel Management, the Department of Labor's program for Black Lung beneficiaries and the Railroad Retirement Board (RRB).[53] Like SSA, these federal agencies have authority to pay benefits, including retirement pensions, to persons other than the primary beneficiary upon an agency finding that the beneficiary's interests would be served thereby. Of all the federal representative payee programs, the VA program provides the most distinct alternative to the SSA program, in its more paternalistic, individualized, and comprehensive approach.

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[52] See generally, Commission on the Mentally Disabled and Commission on Legal Problems of the Elderly of the American Bar Association, "Guardianship An Agenda for Reform: Policy of the American Bar Association" (1989). Because there is incomplete data on the number of persons under state guardianships (the number is sometimes estimated to be between 300 and 500 thousand) it is difficult to determine the total number of children and adults who are subject to either guardianship or representative payee arrangements. It is even more difficult to secure data on the number of persons whose affairs are managed by trustees, professional financial managers, and persons with powers of attorney. Nevertheless, statistics on persons subject to representative payees appointed by the SSA suggest that their numbers are significant and growing.

[53] Veterans Administration representative payee authority is found at 38 U.S.C §§3202-04 (Supp. 1988); 38 CFR §13.1 to 13.111 (1987); Railroad Retirement Board representative payee authority is found at 45 U.S.C. §231k (1986); 20 CFR §§266.1 to 266.13 (1988); Office of Personnel Management's authority to appoint representative payees for retired federal employees is found at 5 .U.S.C. §8345(e) (1980). Like the Secretary of HHS and the Administrator of the VA, the Railroad Retirement Board (RRB) is given authority by Congress to make payments due to beneficiaries of the Railroad Retirement Program directly or to a representative payee when the beneficiary's interests would be served thereby. 45 U.S.C. 5231K (1988) 20 CFR §§266.1 to 266.13 (1988). This authority was not given to the RRB until 1974 and so its experience with the program is more limited. Of the 1,075,000 adult beneficiaries of the program, 17,984 have either a court-appointed guardian receiving their benefits or a representative payee appointed by the RRB. Letter of Beatrice Eserski, Secretary to the Railroad Retirement Board to Honorable Don Bonkers, Chairman, Subcommittee on Housing and Consumer Interests, Select Committee on Aging, H.R. (August 16, 1988). The RRB's administration of the representative payee program is very similar to that of the SSA. Personnel in field offices determine the need for representative payment, select the payee, monitor the payee's performance, investigate misuse of funds and change the payee if necessary to protect the interests of the annuitant. Like SSA, the RRB will not appoint a representative payee solely for the convenience of the annuitant. RRB - FOM, §1405.10 (1988). Determinations of incompetence are based on adjudicated incompetency, medical evidence and "the nature of the [beneficiary's] disability and his

Certification of a representative payee to receive benefits by a federal agency such as SSA,[54] the VA,[55] the Railroad Retirement Board[56] and the Office of Personnel Management[57] differs from appointment of a guardian in several respects. The determination of need for assistance is made by an administrative agency rather than a court; more informal procedures are used to determine need; the legal authority transferred to the payee is less comprehensive than that transferred to a guardian; and the property affected is limited to certain government provided benefits. However, while a federal representative payee has power to control only benefits dispensed by the appointing agency, in fact, the power to control such funds, especially when they are the sole or major source of the beneficiary's income, gives representative payees effective authority to determine where the beneficiary will live, what he or she will wear, where he or she will go, and with whom he or she may associate, much like a guardian.[58] While there seems to be little reliable data on the number of state guardianships in effect at any one time, it has been estimated that they do not exceed 400,000--only about 20 percent of

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demeanor." RRB - FOM §1410.10 (1988). Many of the observations about the appropriate administration of the SSA's representative payee program would apply to the Railroad Retirement Board's program as well. Of the 85,995 recipients of benefits under the Black Lung Program, only 1103, or less than 1-1/2 percent, currently receive their benefits through a representative payee. Letter of Ann McLaughlin, Secretary of Labor to Honorable Don Bunker, Chairman, Select Committee on Aging, H. R. (September 8, 1988). The authority to appoint a representative payee was given by Congress to the Secretary of Labor and has been expanded in regulations issued by the Department of Labor. The regulations provide that payment of black lung benefits will be made only to the beneficiary, a legal guardian or a payee appointed by the Secretary. 20 CFR §725.505 (1990). The Deputy Commissioner of the Division of Coal Mine Workers Compensation administers the program. The regulations simply provide that "if the deputy commissioner determines that the best interests of a beneficiary are served thereby, the deputy commissioner may certify the payment of such beneficiary's benefits to a representative payee." 20 CFR §725.510 (1990). At any time thereafter, the deputy commissioner may require the payee to submit evidence of his or her relation to the beneficiary and to submit periodic reports including a full accounting of the use of all certified benefit payments.

[54] 42 U.S.C.A. §§405(j) 1382(a)(2) (1988); 20 CFR§§404.2001 to 404.2065 (1990).

[55] 38 U.S.C. A. §3202-04 (1988); 38 CFR §§13.1 to 13.111 (1987).

[56] 45 U.S.C.A. §231k (1986); 20 CFR §266.1 to 266.13 (1988).

[57] 5 U.S.C.A. §8345(e) (1980).

[58] Surrogate Decisionmaking at One-15 and One-16 (1988).

the number of adults for whom SSA has appointed a representative payee.[59] As discussed below, unlike the VA, SSA has no authority to initiate state guardianship proceedings for incapable SSA beneficiaries.

This study compares the standards and procedures used by SSA to determine the need for representative payees with those used to determine the need for guardians of the estates of incompetent persons under state guardianship laws and those used for similar purposes by the VA. In general, state guardianship proceedings provide more procedural safeguards to proposed wards, require more complete accounting from fiduciaries, serve fewer people and deprive the ward of more liberty and property interests than do SSA's representative payee determinations. Likewise, although using a different approach, the VA's fiduciary program serves a much smaller number of beneficiaries than SSA's and provides more individualized services. The VA program is also more expensive to operate than the SSA program. With its current budget, it may be difficult for SSA to replicate either or both of these models, but it may be possible for SSA to utilize them for beneficiaries who qualify to be served by them.[60]

## A. State Guardianship

SSA's authority to take control of the disposition of this one kind of private property is similar to the long recognized *parens patriae* authority of the states to take control of the person or property (including entitlements to government benefits), of individuals found to be mentally or physically incompetent to manage their affairs. Therefore, it is useful to compare the standards and procedures used in state guardianship proceedings. Conceptually, state guardianship can be viewed as an effort to promote individual and social welfare through the imposition of assistance, but only if individuals' liberty and property interests, given a preferred status, were protected by procedures intended to produce accurate determinations about the justifications for the limitation of those rights. This concept derives from a regulatory model designed to reconcile competing claims of government authority and private autonomy by enssuring the accurate application of legislative directives.[61] As in the case of economic regulation, the broad discretion to carry out the state's intended intrusion on private interests granted by guardianship statutes to the courts is not effectively limited by either statutory directives or procedures so as to provide for consistent, predictable, principled decisions.

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[59] Associated Press, "Guardians of the Elderly: An Ailing System," Special Report (1987) at 2. The number of persons under guardianship and conservatorship may include some persons who do not have a representative payee appointed by SSA.

[60] The OBRA 1990 amendments require SSA to conduct a demonstration project to determine the feasibility of VA acting as the lead agency in the appointment of payees for incapable beneficiaries eligible for both SSA and VA benefits. Pub. L. No. 101-508 §5105(d)(3).

[61] Stewart, supra note 12 at 1669-1670.

The state's *parens patriae* powers are derived from the Anglican theory that the king or sovereign, as the protector of the people, had authority and responsibility to protect the person and estate of minors, lunatics (one who has lost his senses) and idiots (one who lacks intelligence and has never had his senses).[62] It was assumed under common law that the mental condition of such persons prevented them from making reasonable decisions and that they were proper subjects for the king's protection. On the other hand, persons who were not so disabled mentally, were not so protected--no matter how foolish and unreasonable their decisions.[63]

Today, there are guardianship laws of various kinds in all 50 states which authorize the appointment of a guardian when an individual is determined mentally or physically incapacitated in accordance with various definitions of incompetence.[64] In practice, "incompetency" is a legal conclusion which indicates when the state will take action that limits a person's right to control the disposition of his or her property and make personal decisions. In state guardianship proceedings, this legal conclusion may follow from factual findings about mental processes or their supposed product or both.[65]

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[62] Prior to the 14th century, guardianship was a function of the lord of the manor, who protected both the person and the property of mentally incompetent persons largely to prevent the dissipation of assets to which heirs would become entitled and to prevent the subject from becoming a burden on the lord. See De Praerogative Regis, 17 Edw. 2, cs. 9, 10 (1324); 1 W. Blackstone, Commentaries, section 460 (Chitty 1889) and 2 L. Shelford, *A Practical Treatise on the Law Concerning Lunatics, Idiots and Persons of Unsound Mind* 7 (1833), cited in S. Brakel, J. Parry and B. Weiner, The Mentally Disabled and the Law 369 (1985); A. Deutsche, *The Mentally Ill in America: A History of Their Case and Treatment from Colonial Times* (2d ed. 1949). Later, this authority was extended to mentally ill as well as mentally deficient subjects. According to Parry: The king's guardianship was exercised through the Lord Chancellor, by virtue of a special commission issued to him by the Crown rather than by the general authority of the chancery court. In exercising the power, the Chancellor held an inquisition to determine the condition of the mentally disabled person and to appoint a committee for his person and property if he was adjudged an "idiot" or a "lunatic." It was the further duty of the chancery court to supervise and control the conduct of such a committee. S. Brakel et al *supra* at 369.

Today, the term "guardian" is most often used to refer to a guardian of the person or a guardian of the person and the estate of an incompetent. A guardian of the estate alone is often referred to as a "conservator." Uniform Probate Code section 1-201(6)(15). The term "guardian" is used in this article to mean a court-appointed protector of the person and/or estate of an incompetent person. See generally, the American Bar Association, *The Mentally Disabled and the Law* XV (rev. ed. S. Brakel and R. Rock 1971); Kindred, "Guardianship and Limitations Upon Capacity, in The Mentally Retarded Citizen and the Law 62 (1976); Horstman, "Protective Services for the Elderly: The Limits of Parens Patriae, 40 MO. L. REV. 215 (1975); Mitchell, "The Objects of Our Wisdom and Our Coercion: Involuntary Guardianship for Incompetents, 52 S. CAL. L. REV. 1405 (1979); Comment, "The Disguised Oppression of Involuntary Guardianship: Have the Elderly Freedom to Spend?" 73 YALE L. J. 676 (1964).

[63] W. Blackstone, *Commentaries*, Section 306 (Chitty 1889): "When a man on an inquest of idiocy hath been returned an unthrift and not an idiot, no further proceedings have been had."

The effect of a finding of legal incompetence also varies from state to state. In some states, legally incompetent persons may not make any legally binding decisions, drive a car, vote, transfer property, marry, or engage in civil service employment.[66] However, over the last several decades, courts and legislatures have taken a more selective approach to limiting the legal rights of incompetents, and have required separate determinations of their capacity to exercise different rights.[67] Most notable was the separation of determinations of incompetence and commitment to mental institutions. Many states which had made mental incompetence an essential finding in commitment proceedings, no longer disenfranchise persons from the exercise of all civil rights when they are committed to an institution for treatment.[68] In addition, an increasing number of states have passed "graded guardianship" laws which permit the granting of limited powers directly related to the functional impairment of the ward.[69]

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[64] For a compendium of state guardianship statutes and definitions of incompetence see S. Brakel, J. Parry and B. Weiner, The Mentally Disabled and the Law Tables 7.1 to 7.6 (3rd. ed. 1985).

[65] Some states' definitions of incompetency turn on mental status and particular mental conditions or categories of impairments, such as old age, alcoholism, mental retardation, senility or mental illness. Others turn on decisionmaking ability (i.e., the ability to function in society or to care for self and property). Some require both--a failure to function satisfactorily in society and that the failure be caused by a mental or physical disease or defect. S. Brakel, J. Parry and B. Weiner, "Incompetency, Guardianship, and Restoration," The Mentally Disabled and the Law 371-379 (1985). Because mental incapacity is evidenced by functional deficits, proof of imprudent or unusual behavior is sometimes accepted as sufficient proof of incompetency. Some commentators criticize this conclusion, arguing that mental incompetency is the inability to "understand and appreciate the facts necessary to reach an informed decision and to convey that decision" and not the resulting imprudent decision. ABA Commission on Mentally Disabled, Guardianship and Conservatorship: Statutory Survey and Model Statute, section 3(1) comment (1979). The conclusion that imprudent decisions are a result of impaired minds is not logically or empirically compelled, they maintain. Therefore, unless the state is to take over decisionmaking for imprudent persons, (with no clear mandate or understanding of what is prudent), incompetency determinations must focus not on the quality of the decision, but the quality of the thought processes that produce it. Frolik, "Plenary Guardianship: An Analysis, A Critique and a Proposal for Reform," 23 ARIZ. L. REV. 599, 603 625-629 (1981). Like state determinations of incompetence, under present regulations, SSA determinations of incapability can be made on the basis of evidence of imprudent decisions rather than on more objective assessment of mental and physical abilities.

[66] S. Brakel, J. Parry and B. Weiner, *The Mentally Disabled and the Law*, 374 (1985).

[67] *Id.*

[68] In 1985, 42 states and other jurisdictions have laws which specify that an individual's competency is not affected by voluntary or involuntary commitment to a mental institution. S.

As will be discussed in more detail below, state guardianship laws provide a judicial forum and more formal procedures than SSA provides in its administrative forum for incapability determinations. These procedures are largely intended to protect persons from the erroneous deprivation of their legal right to control their own property and to make life decisions for themselves. In addition, formal procedures may serve other purposes, such as the development of consistent standards through precedential adjudications, respect for the dignity of persons subjected to guardianships, and public acknowledgement of the importance of individual property rights and liberty in our society. Procedures are not without their cost, however, and some may be inappropriate for the determination of capability for only limited purposes. In effect, the Supreme Court requires a weighing of the costs and benefits of such procedures for due process purposes.[70] The interests at stake in state guardianship proceedings, with which SSA proceedings are contrasted in this study, have been determined by courts and legislatures to be of sufficient weight to merit the procedural safeguards of a full evidentiary, adversarial judicial proceeding.

## B. The Department of Veterans Affairs' Fiduciary Program

The VA, like the SSA, uses an administrative rather than judicial forum to provide its equivalent of representative payment. If the value of state guardianship lies in its formal procedures to safeguard individual rights, the value of the VA fiduciary system may be seen as its bureaucratic structure for carrying out its institutional mission of beneficence. Unlike either state guardianship or the SSA program, the VA program provides an array of services to troubled veterans from pensions to hospital care, evaluates their medical and functional status and offers individualized services fostering assisted independence. As discussed below, the VA's determinations of competence are made by an expert rating board, which includes a physician. It

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Brakel, J. Parry and B. Weiner, *The Mentally Disabled and the Law*, Table 7.2 (1985). However, 18 jurisdictions still permitted the superintendent of a mental institution to curb the individual rights to maintain operation of the facility.

[69] American Bar Association, Commissions on Mental Disability and Legal Problems of the Elderly, "*Guardianship An Agenda for Reform: Policy of the American Bar Association*" 16 (1989).

[70] See discussion at notes 256-267 infra.

provides beneficiaries predetermination notice and an opportunity to be heard. However, unlike state guardianship proceedings, VA incompetency hearings before the rating board do not provide an adversary evidentiary hearing. Rather, VA hearings are informal, with the board members taking an active role in developing evidence. The board has the authority to obtain opinions from VA doctors and other medical personnel who are instructed to perform standardized medical procedures to assess the competence of beneficiaries proposed for fiduciary payment. Furthermore, until recently, final VA determinations of competence and the need for fiduciary payment were not subject to judicial review. The scope of judicial review currently provided in the Court of Appeals for the Federal Circuit is unclear.[71]

The statutory authority granted the VA Administrator is similar to that granted the Secretary of HHS. Thus, the Administrator is given authority to pay a veteran's benefits to another person, called a "fiduciary," when it is determined to be in the beneficiary's interests to do so.[72] The VA's authority is older than that of the Secretary of HHS, having been included in the Administrator's fiduciary oversight activities in the early 1920s. The purpose of the authority is regarded to be twofold: first, to prevent fraud, waste and abuse of public funds; and second, to protect the interests of the incompetent or legally disabled beneficiary and the interests of the beneficiary's dependents.[73]

The VA fiduciary program provides more comprehensive protection to a much smaller beneficiary population than SSA's representative payee program. Unlike SSA, which makes $25 billion in representative payment to more than 10 percent of all social security beneficiaries or between 4 and 5 million beneficiaries, the VA supervises the payment of some $1.12 billion in benefits to about 3.10 percent of its beneficiaries or 124,300 incompetent or legally disabled beneficiaries.[74] Perhaps this significantly smaller caseload has permitted the VA to take a more assertive role in identifying beneficiaries who need protection and a more active role in supervising the use of benefits on their behalf. In addition, the VA's statutory authority includes the authority to charge the beneficiary's estate for the costs of providing a fiduciary, as well as the costs of participating in court proceedings adjudicating the interests of the beneficiary and the adequacy of the fiduciary's performance.[75] The VA's ability to pay for payee services makes it easier to find fiduciaries for veterans than for SSA to find payees for some beneficiaries. The absence of such authority in the Social Security Act could arguably indicate that Congress does not intend the Secretary to take such an active role in finding and assisting social security beneficiaries nor to utilize state guardianship adjudications and accounting procedures. More likely it indicates only an implicit recognition of the fact that social security insurance and welfare benefits provide only bare maintenance to recipients and that the deduction of administrative costs for representative payee services could work a hardship for some beneficiaries.

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[71] Stichman, "*The Veteran's Judicial Review Act of 1988: Congress Introduces Courts and Attorneys to Veteran's Benefits Proceedings*," ADMIN. L. REV. 365, 380-383 (1989).

[72] U.S.C. §3202 provides:

> Where it appears to the Administrator that the interest of the beneficiary would be served thereby, payment of benefits under any law administered by the Veterans Administration may be made directly to the beneficiary or to a relative or some other person for the use and benefit of the beneficiary, regardless of any legal disability on the part of the beneficiary.

38 U.S.C. §3202 (1988). Statutory authority for the Administrator's activities in carrying out this authority is found at 38 U.S.C. §§3201-3204 and 3501. Regulations promulgated pursuant to the authority are found at 38 CFR Parts 13 and 14 (1988) and implementing guidelines are found in the Department of Veterans Affairs Manuals 27-1, Part III, chapters 1-10; m27-1, Part IV; and VA Program Guide PG 27-1.

[73] Letter of Thomas K. Turnage, Administrator, The Veterans Administration, to Honorable Don Bonker, Chairman, Subcommittee on Housing and Consumer Interests, House of Representatives, Washington, DC, October 8, 1988.

The VA has been granted authority to take a number of different actions to *protect* vulnerable veterans--from intervening in guardianship proceedings, to withholding payments to fiduciaries in order to meet the individual needs of the beneficiary.[76] Thus, unlike SSA, the VA itself will supervise and assist beneficiaries in handling their funds in certain situations, will appoint a fiduciary to perform the same functions, or will seek a state appointed guardian when the VA deems it in the best interests of the beneficiary to do so. VA field examiners make periodic personal visits to beneficiaries who are under "supervised direct payment" or who have appointed fiduciaries, and estate analysts take an active role in monitoring the way in which the veteran's total income and assets are handled by a VA fiduciary or guardian.

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[74] Veterans Administration, "Significant Fiduciary and Field Examination Program Statistics," attachment to Letter of Thomas K. Turnage, Administrator, The Veterans Administration, to Honorable Don Bonker, Chairman, Subcommittee on Housing and Consumer Interests, House of Representatives, Washington, DC, (October 8, 1988.) This number does not include some 3,000 institutionalized beneficiaries who do not receive direct payment or the 5,000 to 6,000 children who receive representative payment over which the Administration retains no supervisory function. Interview with William Saliski, Jr., Acting Assistant Director of Program Management, the Veterans Administration, September 9, 1989. About 60 percent of the VA's adult beneficiaries whose benefits are paid to a fiduciary are over 60 years old. Veterans Administration, Statistical Data, appended to Letter of Thomas K. Turnage, Administrator, The Veterans Administration, to Honorable Don Bonker, Chairman, Subcommittee on Housing and Consumer Interests, House of Representatives, Washington, DC, October 8, 1988.

[75] 38 U.S.C. §3202 (1988).

[76] *Id.*

Not only does VA provide more social services to incapable beneficiaries, it makes incapability determinations on the basis of more informed expert opinion. When an adult beneficiary has been determined incompetent by a state court, or if evidence is received that the beneficiary may be incompetent to handle veterans' benefits, the information is given to the VA field station.[77] Most of the field stations have field examiners who investigate the need of beneficiaries and estate analysts who audit the accounts of payees and guardians acting on behalf of incompetent veterans. The examiners are responsible for investigating the need for appointing a fiduciary or for supervised direct payment, and are instructed by VA to make personal contact with the beneficiary in doing so.[78] Where a beneficiary in direct payment is thought capable of handling benefits only with assistance, the beneficiary is placed in supervised direct payment and a field examiner works with the beneficiary to establish a budget and provides advice on expenditures.[79] Field examiners are given detailed instructions concerning investigating and documentating evidence of competency.[80] They may recommend, but are not authorized to make, competency determinations. Competency determinations are made by an expert Rating Board that considers the evidence provided to it by the field office, the beneficiary and examining physicians. Beneficiaries may request a hearing before the board or participation in a hearing requested by the field office. Such hearings are nonadversarial, informal hearings in which the board members take an active exploratory role.

Finally, until recently, the professional judgments upon which VA incompetency determinations are based were final. A finding of incompetency by the VA is appealable by the beneficiary, as will be discussed below, but a candidate for appointment as fiduciary may not appeal his or her nonappointment or removal.[81] Before 1988, there was no judicial review of final determinations of the VA's highest administrative adjudicatory body. Now such determinations are reviewed by a newly created article I court and the Court of Appeals for the Federal Circuit, which has authority to overturn decisions which are "clearly contrary to law."[82] The field examiner may require an accounting at any time for the protection of the beneficiary's interest.[83] When problems arise between the beneficiary and fiduciary, the field examiner will mediate the dispute, but may also order repayment of funds and remove the fiduciary.

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[77] VA Manual, M27-1, Part III, Ch. 5. (1986)

[78] VA Manual, M27-1,Part III, Ch. 2, §5.01(b)(2) (1986). The Manual states "Interviews will be conducted at home, place of business, or other place that will serve the convenience of the person interviewed. Interviews should be scheduled and conducted so as not to cause the interviews lose of earnings, expense or embarrassment. Field examiners also follow-up after such action to reassess competency and determine whether the beneficiary's needs are being met. Follow up field examinations may be scheduled for less than one year or up to four years apart." *Id.*

[79] *Id.* at §6.07 (1987).

[80] VA Manual, M27-1, Ch.s 5 and 6 (1986 and 1987).

[81] *Sena v. Roudebush*, 442 F. Supp. 153 (D.N. Mex. 1977).

VA also provides much more extensive monitoring of fiduciary performance than SSA. The VA estate analysts are responsible for maintaining and auditing accounts received from fiduciaries, including determining the appropriateness and legality of investments.[84] Analysts may order fiduciaries to provide surety bonds for the faithful performance of their duties, upon consideration of listed factors relevant to the likelihood of misfeasance. On occasion, the analyst may work with the fiduciary and/or a court with jurisdiction over guardian-fiduciaries to resolve discrepancies or raise potential objections. Analysts sometimes become so involved with particular cases that they act as surrogate fiduciaries, approving expenditures and budgets. Field examiners can become similarly involved with beneficiaries whose funds are paid directly but under the supervision by the field office.

Not surprisingly, the VA's fiduciary program is more costly on a per capita basis than either the SSA representative payee program or the Railroad Retirement Board program. At the close of fiscal year 1988, the VA program utilized 373 employees including 246 field examiners, 14 attorneys and 113 estate analysts. In 1987, the program cost the VA about $14.3 million to operate, or about $115.32 per beneficiary annually. Completely comparable figures for SSA are not available but total SSA cost per beneficiary in representative payment is clearly much lower than that incurred by the VA. SSA has indicated the cost of monitoring payees alone is about $2.17 per beneficiary annually.[85] Defenders of the VA's more paternalistic approach to the fiduciary program note that the program recovered about $7.3 million in misused funds[86] and prevents the misuse and irresponsible expenditure of millions more. To the extent that Congress has not provided funds to pay for comprehensive payee services either from social security benefits or through SSA, while it has provided more generous appropriations to support VA's more paternalistic fiduciary activities, it may be argued that Congress is more responsive to the needs of veterans of the armed forces than to the needs of social security beneficiaries, who include many people on welfare.

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[82] Veterans Judicial Review Act, Pub. L. No. 100-687, 102 Stat. 4105, 4113, codified at 38 U.S.C. §4052 (1990).

[83] 38 CFR §13.100 (1990).

[84] VA Manual, M27-1, Ch. 8, §8.02 (1987); VA Manual, M27-1, Ch. 8, §8.23 (1987).

[85] *Jordan v. Schweiker*, Civ.-79-994-W, p. 16 (March 17, 1983).

[86] Fiduciary Program Briefing presented to the Administrator of Veterans Affairs at 6.

As discussed below, SSA is not compelled either by the Constitution or its organic act to emulate either the rights-oriented state guardianship process, with its emphasis on procedural safeguards for the protection of individual liberties, or the more benevolent VA system, with its provision of continual, comprehensive management assistance and monitoring tailored to individual needs. Nevertheless, SSA's failure to comport with either indicates an institutional ambivalence on the part of the agency, making effectuation of either beneficiaries' liberty interests or their interest in receiving assistance problematic. The absence of statutory or constitutional directives to guide its discretion in striking a balance between the two, raises significant managerial and even legitimacy questions about the SSA program.

## IV. Determining A Beneficiary's Need For in Representative Payment: The Standard

With hundreds of thousands of representative payee determinations occuring annually, issues of mass justice necessarily arise. They concern SSA's institutional capacity to make such determinations accurately, efficiently and fairly in the enormous number of cases in which it is called upon to do so. Sections four and five of this report explore the substantive and procedural requirements and limitations imposed by the Constitution, the agency's organic act and the Administrative Procedure Act on the Secretary's discretion to determine whether a beneficiary is in need of representative payment. These legal constraints are intended to assure that such discretion will be exercised reasonably, for the purpose Congress intended and with regard to the constitutional and statutory rights of beneficiaries. However, as applied to SSA's representative payee program, they may be insufficient to insure justice on a mass basis for several reasons.[87]

First, due process doctrine articulated in *Mathews v. Eldridge* and subsequent cases to establish constitutionally minimal procedural requirements, would require SSA office personnel, administrative law judges and courts to weigh the unquantifiable, nonfinancial interests of beneficiaries in self-esteem and autonomous disposition of benefits and the public's interests in assisting certain beneficiaries and in the wise expenditures of federal funds, without a constitutional standard of value against which to weigh them. Second, no statutory standard is provided by the Social Security Act. Although the Congressional grant of broad discretionary authority to the Secretary may be sufficient to meet constitutional requirements, in light of the mixed objectives of representative payment and the inconclusiveness of relevant legislative history, the Social Security Act provides little legislative direction to agency policy makers indicating how the values of liberty and beneficence are to be accommodated in many instances. Third, although the agency has circumscribed its discretion somewhat by promulgating regulations which restrict indirect payment to those beneficiaries found by the agency to be incapable of managing their benefits, the agency has failed to provide a meaningful standard of "incapability" against which courts might measure administrative action challenged as arbitrary and capricious. Nor does the APA require the promulgation of regulations defining capability: it simply requires that if SSA chooses to define it, it must do so in a specified way. Finally, beneficiaries, as a group, would seem to lack the knowledge and resources necessary to invoke even the evidentiary standards that have been established by the agency. Thus, the Constitution, the statute and the APA leave the problem of SSA's ambivalence in the exercise of its broad administrative discretion unresolved.

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[87] See generally, Stewart, "*The Reformation of American Administrative Law*," 88 HARV. L. REV. 1667, 1669 - 1688 (1975).

## A. Current SSA Practice

SSA has promulgated regulations and implementing program guides that limit its discretion to certify indirect payment of benefits more narrowly than either the Constitution or the Social Security Act would seem to require.[88] The agency will appoint a payee only when it determines that a beneficiary is mentally or physically "incapable" of managing or directing the management of his or her own benefits and that indirect payment is in the beneficiary's interest. However, as mentioned above, these regulations fail to establish a standard against which a beneficiary's interest is to be measured. There is no definition of "incapability" to guide the discretion of SSA claims representatives or health professionals in making their determinations.

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[88] Apart from regulations, SSA has further articulated its policy with regard to the withholding control over entitlements in its Program Operating Manual System (POMS). This manual is a compilation of detailed policy instructions and step-by-step procedures intended to guide SSA personnel in carrying out their responsibilities under the Social Security programs. Because SSA considers its POMS to consist of interpretative rules and general statements of policy, and thus exempt from APA rulemaking requirements, the instructions concerning representative payment contained in the POMS are not promulgated after public notice and opportunity for comment. Nor is the POMS regarded by the agency as binding on administrative law judges or the SSA Appeals Council. See H.R. Rep. No. 98-466, 98th Cong. 2d Sess. at 21-22 (1984); H.R. Conf. Rep. No. 98-1039 at 35 (1984)(Social Security Disability Benefits Reform Act of 1984). The POMS consists of over 30 volumes of detailed instructions and is maintained in local social security offices but is not otherwise easily accessible to the public.

Moreover, SSA regulations require it to act only when evidence or allegations of incapability are brought to its attention by others. Thus, neither the Act nor regulations impose a duty on the agency to protect the funds of all incapable beneficiaries, nor to determine which of the beneficiaries it pays would be presumptively better served if payments were made to a payee. The VA, on the other hand, has interpreted its mission, based on almost identical statutory authority, to include an affirmative obligation to seek out incompetent veterans and assist them through fiduciaries.

The Secretary's discretion to determine that a payee should be appointed is exercised in the first, and often in the last instance, by an SSA claims representative in the local SSA field office.[89] As discussed more fully below, under certain circumstances, an incapability determination by a claims representative is a ministerial act. That is, SSA regulations require the SSA employee to gather specified information, and, if certain facts exist, the claims representative must find that the beneficiary is incapable. This information includes medical opinion and state court adjudications of incompetence. However, there are other circumstances in which an incapability determination is a discretionary act based on the claim's representative's gathering and personal evaluation of information about the individual beneficiary's needs, abilities, life style, etc.

When someone, usually a relative or friend of a beneficiary, proposes to SSA that a representative payee be appointed, a claims representative opens a file and gathers information indicated in the Program Operations Manual System (POMS), SSA's operating manual. After the case has been investigated and "developed," the claims representative is responsible for making the payee decision, sending notices to interested persons, resolving any protests and documenting the initial determination.[90] SSA claims representatives are usually high school graduates and hold civil service journeyman grade level ratings of GS-10. They are trained to collect and record specified information and are informed about the sufficiency of various kinds of evidence (such as state guardianship adjudications) as the basis for a determination of incapability. They are also instructed how to obtain the opinions or determinations of others regarding incapability (such as the opinions of physicians). However, they are not trained to gather or evaluate relevant information about the beneficiaries' functional capacity from neighbors, relatives, landlords, etc., or to form an opinion about the beneficiary's ability to manage benefits based on a standard of minimally acceptable competence approved by the agency.

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[89] POMS §GN 00502.005 (1986). Although the field office servicing a payee applicant may develop the need for representative payment and/or recommend the best payee, all material must be forwarded to the field office with jurisdiction for the beneficiary (if indirect payment) or the representative payee of record.

[90] *Id.* The SSA processing center has responsibility for sending advance notices and may make representative payee decisions in certain circumstances. POMS §GN 00502.005 (1989).

A beneficiary does not receive an "advance notice" until *after* a claims representative has sought information and evidence about the beneficiary's ability to manage benefits, made a determination that a payee is needed based on the information, and selected a payee. This notice informs the beneficiary that such a determination has been made, that he or she may review the evidence and information upon which the determination was based, and protest the determination before payment is made to the selected payee. If the determination is confirmed by the claims representative after a protest, the decision is implemented (i.e., checks are made payable to the representative). The beneficiary is then sent a "final notice" of an "initial determination" and is entitled to seek reconsideration of the decision by another claims representative. If the decision is again confirmed, the beneficiary is entitled to seek de novo review from an administrative law judge and appellate review from SSA's Appeals Council.

There is little data concerning the extent to which the "initial determinations" vary from the original determinations. Typically both are made by the same claims representative. SSA does not collect data on the average length of time such determinations take, the number of such determinations made each year, the number of determinations protested, the number appealed or the number overturned at each stage. Some SSA personnel note that SSA workload reports used to evaluate personnel performance undervalue of the amount of time necessary to adequately handle representative payee matters.[91] This may create disincentives for claims representatives to spend the time necessary to handle payee matters well.

## 1. The Lack of a Substantive Standard

The Act does not provide the Secretary with standards to guide the determination that representative payment would "serve the interests" of the beneficiary.[92] Congress' purpose in authorizing the Secretary to make such determinations may have been (1) to assist beneficiaries with or without their concurrence; (2) to assure the responsible expenditure of publicly-arranged benefits; or (3) to effectuate the autonomy interests of incapable beneficiaries in controlling the expenditure of benefits by providing a surrogate to exercise their right to control the expenditure of benefits.[93] These purposes may serve to guide the Secretary's discretion even though the express terms of the Act do not. However, in some circumstances these purposes may conflict and the agency is left without guidance to resolve the conflict.

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[91] E.g.,, Testimony of Kim P. Gaines, SSA Claims Representative and Local President Designee of American Federation of Government Employees AFI-CIO, Local 3172, Hearings before Special Comm. on Aging, U.S. Senate, 101st Cong. 1st Sess. at 74 (June 6, 1989).

[92] More specifically, in Title II of the Act, Congress determined only that the Secretary *may* make payment to a person other than the beneficiary when it appears to the Secretary that the interest of an applicant would be served thereby, irrespective of whether the beneficiary has been determined legally competent or incompetent. 42 U.S.C. §405(j)(1) (1990). In Title XVI it determined that the Secretary *shall* make representative payment where the beneficiary is entitled to benefits solely on the basis of being disabled and a medical finding has been made that the

Nor has Congress expressly required the Secretary to promulgate standards to guide the exercise of agency discretion, although it does authorize him or her to do so. Nevertheless, SSA has implemented its broad statutory authority by regulations limiting its discretion to appoint a payee to those instances in which SSA or some other designated decisionmaker has determined that the beneficiary is mentally or physically incapable of handling benefits. In keeping with its waiver of the "grants and benefits" exemption from the APA's requirement for informal rulemaking,[94] SSA has issued regulations, after public notice and comment, that explain that representative payment will be made when SSA determines that "due to a mental or physical condition or due to their youth," a beneficiary is "unable to manage" his or her own benefits.[95]

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person is addicted to drugs or alcohol.42 U.S.C. §1383(a)(2)(A)(ii) (1990)). In addition, the Secretary *may* make such payment of Title XVI benefits where the recipients interest would be served thereby. *Id.* The 1990 amendment to section 1631 (42 U.S.C. 1383(a)(A)(2) changed the language of the Secretary's authority but not its effect. The provision now reads that the Secretary "shall" appoint a payee for all Title XVI beneficiaries whose interests would be served thereby as well as Title XVI beneficiaries whose disability is due to alcohol or drug abuse. This new statement of the Secretary's authority does not require him to find representative payment in the interest of any beneficiary except those whose disability is due to addiction, but having found representative payment to be in a beneficiary's interest, the statute would require payment to a payee. Thus, with regard to other SSI recipients and all Title II beneficiaries, Congress has allowed the Secretary broad discretion in carrying out its intent. The Secretary might have construed the grant of authority narrowly and ministerially. For example, the Secretary might have provided by regulation that representative payment would be considered in the beneficiary's interest if and only if the beneficiary has been adjudicated incompetent by a state court.

[93] See text at notes 154-162 infra.

[94] 36 Fed. Reg. 2532 (Feb. 5, 1971) (waiving the exception to informal rulemaking requirements contained in the Administrative Procedure Act, §553(a). Herron v. Heckler, 576 F. Supp. 218 (N.D. Calif. 1983) (HHS waiver held legally binding). In 1982 the Department of Health and Human Services proposed withdrawing the waiver but did not act on the proposal. 47 Fed. Reg. 26860 (1982).

[95] 20 CFR §404.2001 et seq. and 20 CFR 416.601 et seq. (1990). The regulations provide that a payee will be appointed when it is determined in the beneficiary's interest and that "generally, we appoint a representative payee if we have determined that the beneficiary is not able to manage or direct the management of benefit payments in his or her interest."

While the regulations do not expressly make a determination of inability to manage either a necessary or sufficient condition for the appointment of a payee, SSA's program manual regards a finding of incapability to be both. That is, *if* the beneficiary is found incapable of managing benefits, and *only if* the beneficiary is so incapable, will a payee be appointed.[96] Thus, SSA's regulations would not permit the appointment of a payee when a person is unable to manage his or her benefits, but such inability is not due to a mental or physical impairment or youth (as might occur if a beneficiary were unable to manage benefits because they were improperly appropriated by family members). Nor would SSA permit the appointment of a payee where the beneficiary is capable of managing benefits, but in the Secretary's opinion the appointment of a payee would be in the beneficiary's interest. For example, no appointment could be made for a beneficiary able to manage benefits to secure basic food, shelter and clothing who, instead, uses benefits to abuse alcohol or gamble. Imposing representative payment in the latter case would require SSA to become the monitor of the prudence of all benefit expenditures. In practice, such monitoring may sometimes occur because evidence of the first factor--failure to manage benefits in accordance with some minimal standard of acceptable management--may be taken as evidence of the second factor, a mental or physical condition which is responsible for the failure. It is the latter factor which establishes a test of incapability or inability to manage, as opposed to a test of failure, refusal or neglect to manage benefits appropriately.[97]

Yet, SSA's regulations permit the concepts of "failure to manage" and "impaired mental condition" to merge so that failure to manage may be treated as evidence, sometimes conclusive evidence, of mental infirmity. That is, expenditures deemed inappropriate by the decisionmaker are themselves considered sufficient evidence of mental infirmity to permit the appointment of a payee. The merger, in effect, gives a claims representative or physician

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[96] However, as discussed below, the indications listed in the regulations upon which an SSA determination may be based are not themselves necessary conditions, although each one is a sufficient condition. That is, they do not exclude other cases by establishing conditions necessary in every case to a determination of incapability. Not all beneficiaries determined to be incapable must be found to be so by a physician. However, each indication of incapability is a sufficient condition. This beneficiary who has been adjudicated competent by a state court may nevertheless be found incapable of managing his or her benefits by SSA if a doctor believes he or she is incapable of managing benefits.

[97] SSA determinations of incapability can turn on a number of standards, including those used by state guardianship proceedings, by physicians and claims representatives. Some of these standards require findings of mental or physical impairment and some do not. SSA regulations imply but do not clearly state, that SSA personnel are to appoint payees only for beneficiaries found incapable of handling their benefits "due to a mental or physical condition."

Yet, SSA's regulations permit the concepts of "failure to manage" and "impaired mental condition" to merge so that failure to manage may be treated as evidence, sometimes conclusive evidence, of mental infirmity. That is, expenditures deemed inappropriate by the decisionmaker are themselves considered sufficient evidence of mental infirmity to permit the appointment of a payee. The merger, in effect, gives a claims representative or physician great latitude to tilt the scales in favor of providing assistance rather than protecting liberty--that is, to find a beneficiary incapable of managing funds solely on the ground that the beneficiary has used benefits for expenditures which the claims representative or a medical professional does not believe to be in the beneficiary's best interest, whether or not such failure to manage is due to a mental or physical impairment. [98]

Furthermore, even the first factor, an inability to manage benefits, is not defined in accordance with any objective or even articulated standard of minimal competence. As discussed in Appendix I, SSA could promulgate a definition of "capacity to manage benefits" in functional terms--for example, an inability to perform the functions necessary in the beneficiary's situation to secure subsistence levels of food, shelter, clothing and medical care. Instead, SSA has to chosen to rely on the application of a number of different standards utilized for a variety of reasons by persons and agencies other than SSA. Under the regulations, SSA determinations of incapability to manage benefits turn on the various statutory standards applied by state courts in determining legal incompetence, the diverse and unguided opinions of physicians and medical personnel regarding ability to manage, and the standards of other agencies such as the VA and those of the armed services for enrolling minors and placing them on active duty.[99]

The "information" of incapacity upon which the agency will rely is further set forth in the regulations. They state that in addition to a certified copy of a court determination of incompetence and emancipation, SSA "will use medical evidence to determine if a beneficiary is capable of managing or directing the

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imply but do not clearly state, that SSA personnel are to appoint payees only for beneficiaries found incapable of handling their benefits "due to a mental or physical condition."

[98] In addition to mental or physical incapability, the agency must find that the beneficiary's interest would be served by payment to a representative. 20 CFR §404.2001(a) (1990). For a dicussion of such behavior focused criteria for incompetence as part of a trend toward a therapeutic state see Frolick, supra note 51 at 612.

[99] As in the case of legislative classification challenged under the due process clause, the question is whether the correlation between the classification used (for example, a minor in active military service) and the characteristics relevant to legislative purpose (ability to use funds in one's own interest) is sufficiently strong to support use of the former as a surrogate for the latter and render the regulations free from attack on arbitrary and precarious grounds.

the regulations provide that SSA's claims representative will also consider statements of relatives, friends and other people in a position to know and observe the beneficiary in making a determination.[101] The regulations do not provide that statements of the beneficiary will also be considered by SSA, although the agency's informal guidelines suggest that they may. Thus, although the determination must turn on an understanding of what constitutes an "ability to manage" benefit payments, SSA regulations do not define the phrase for SSA personnel or put beneficiaries on notice of what kind of conduct, or lack of it, may result in deprivation of legal authority to expend the benefits to which they are entitled.

## 2. SSA's Evidentiary Standards

### a. Adoption Of State Legal Incompetency Determinations

Although the statute does not require it, SSA regulations and guidelines provide that representative payment will be made for all persons adjudicated legally incompetent under state law.[102] When such evidence is presented, SSA will issue benefits through a representative payee who may be, but need not be, the legal guardian. However, a Social Security Ruling has provided that if the beneficiary is capable of managing his beneifts and needs benefits for the necessities of life, SSA may make direct payment to a person determined legally incompetent.[103] While SSA may be consistent in its utilization of state judicial determinations of incompetency as conclusive evidence of incapability to manage social security benefits, state law standards for the imposition of a guardian of the person or a conservator of the property vary greatly.[104] Some states permit such an appointment solely upon a finding of a mental status, such as lunacy, insanity, idiocy, mental retardation,[105] or advanced age.[106] Others require only a finding of inability to function adequately in society.[107] In 1985, 41 states required both, in that they require that a proposed ward's incompetence stem from a mental illness or deficiency. Similarly, the Uniform Probate Code and Uniform Guardianship and Protective Proceedings Act requires both a finding of mental impairment and a resulting inability to make decisions, so that guardianship is not applied as a broad form of legal paternalism.[108] It defines an incompetent person as:

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[101] *Id.*

[102] 20 CFR §404.2010 (a) (1); POMS §GN 00502.010, A (1989). Recognizing that the appointment of a guardian does not necessarily depend on a finding of legal incompetence, SSA personnel are instructed to secure a copy of the currently operative court order to determine if incompetence was found or to determine if such a finding is required by state law for the appointment of a guardian. Whether SSA is prohibited by the nondelegation doctrine from delegating to state courts its responsibility to determine whether representative payment is in the interest of federal beneficiaries is not clear. There is currently no significant "antidelegation" principle which prevents the Congress from delegating its legislative authority under this enumerated power, to state regulation. The Supreme Court has held that Congress may legislate under its commerce powers in areas in which the states may otherwise exercise their sovereignty, and that Congress may constitutionally adopt state regulation in that effort. However, the applicaion of the principles to an exercise of federal spending power is not so clear. See *Northeast Bancorp Inc. v. Board of Governors*, 472 U.S. (1985). It may be that an exercise of the spending power, as opposed to the power to the regulate interstate commerce, is subject to anti-delegation principles and the restrictions of the Tenth Amendment. See *Pennhurst State School and Hosp. v. Halderman*, 451 U.S. 1, 16, n.2 (1982). Since the Social Security Act has been held to be an exercise of spending power, (see note 132 infra.) SSA deference to state guardianship determinations could be raise constitutional questions about its propriety. See *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985).

> Any person who is impaired by reason of mental illness, mental deficiency, physical illness or disability, advanced age, chronic use of drugs, chronic intoxication, or other cause (except minority) to the extent of lacking sufficient understanding or capacity to make or communicate responsible decisions.[109]

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[103] Soc. Sec. Rul. 62-46 (1962). The VA does not deter to state incompetency determinations automatiacally but intructs VA field personnel to take a number of factors into count in each case to decide whether to recognize an existing court fiduciaryship. VA Manual, M27-1, Part III,

[104] See generally, S. Brakel, J. Parry, and B. Weiner, The Mentally Disabled and the Law 369-434 (3rd. ed. 1985).

[105] See, e.g.,, Ala. Code §26-2-1 (1975 & Supp. 1982).

[106] See, e.g.,, Tenn. Code Ann. §34-1008 (198_).

[107] See e.g., Cal. Prob. Code §1435.2 (West) N.H. Rev. Stat. Ann. §464-A: and see S. brakel, et al. supra note 105 at 383 and Table 7.3 cols 15&16.

[108] For the view that the Uniform Probate Code may be more broadly interpreted see Frolik, "Plenary Guardianship: An Analysis, A Critique and a Proposal for Reform," 23 ARIZ. L. REV. 599, 614-616 (1981):

[109] Uniform Probate Code §1-201(7). Yet, the application of this standard depends on a determination of "responsible" decisionmaking--a term almost as indeterminate as "capacity of manage" and therefore one which permits great discretion. A more appropriate concept for both guardianship and representative payment would seem to entail first, findings of mental or physical impairment, second, findings that the impairment results in an inability to make decisions and third, findings that as a consequence of such inability, the person cannot adequately meet his or her need for food, shelter, clothing and basic health care. As one commentator has noted:

Thus, mental incapacity and a resulting failure to meet basic needs would seem to be necessary conditions to a finding of the need for a guardian or representative payee, while neither one alone would be sufficient. Yet, neither state guardianship statutes, the model code nor SSA representative payee evaluation clearly articulates these separate components clearly. As set out in Appendix I, the ABA Commissions on Mental Disabilities and Legal Problems of the Elderly have recommended a more behavioral approach to defining incompetence, which would require evidence of functional impairment over time.

Furthermore, by making a finding of incompetence by a state court the basis for a finding that a beneficiary is incapable of handling social security payments, SSA is using a number of different standards as bases for appointing a payee. Moreover, these state guardianship standards do not always serve the same purposes as SSA determinations. For example, guardianships may be imposed to prevent assets for the ward's heirs from being dissipated by an incompetent. There is not such inchoatic interest of heirs in the social security benefits subejct to representative payment. Thus, guardians may be appointed under state laws to conserve complicated investments which the owner is found incapable of managing, even though there is no finding that the ward is incapable of spending modest amounts of current income for food, shelter and clothing. Similarly, guardianships are sometimes imposed to prevent exploitation and abuse of vulnerable people, who are otherwise able to handle their benefits on a daily basis.[110] It is not clear whether SSA's concept of incapacity includes circumstances in which a beneficiary is found able to manage expenditures in ordinary circumstances but is susceptible to exploitation.

Finally, SSA has no assurance that the state incompetence determinations upon which it relies are made in accordance with due process procedures required by the Constitution or sound adjudicatory policy. State guardianship

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> Mental incapacity and mental incompetency are not to be confused with unreasonable, foolish or even "crazy" behavior, for it is not the wisdom of the decision but rather the quality of the thought process that is at issue. The concept of mental incapacity serves to ensure that guardianship is not applied as a broad form of legal paternalism; it is therefore not an available remedy even if the individual's activities entail substantial likelihood of self-harm.

Frolik, note 108 supra at 603. See also Partello v. Holton, 9 Mich. 372, 378 (1890); W. Va. Code, §27-11-1(a) (1980) (poor judgment and unusual lifestyle not competent evidence in guardianship proceeding).

[110] Marquart Policy Analysis Associates, Conservatorship of the Elderly: Recommendations for its Interface with Programs and Services for Older Californians, A Report to the Senate Subcommittee on Aging, Hon. Henry J. Mello, Chairman (1988).

proceedings have been criticized for failing to implement necessary procedural safeguards.[111] For example, the statutes of several states fail to require notice of proposed guardianship proceedings.[112] The proposed ward's presence in court is required in only 15 states, and the right to be present is expressly recognized in only 24 states.[113] A random sample study of over 2,000 guardianship proceedings in all 50 states disclosed that 49 percent of the proposed wards were not present at their hearings, while only 8 percent waived their right to be present.[114] And, while 34 states provide legal representation and 36 made a guardian ad litem available when needed, in only 3 percent of the cases sampled did the proposed ward have private counsel, in 17 percent attorneys were appointed by the court, in 31 percent the proposed ward had a guardian ad litem appointed and 44 percent had no representation at all. Jury trials are mandatory in only 5 states and permitted in 23 states. Of the 13 states that specify the standard of proof to be applied in guardianship proceedings, 9 require clear and convincing evidence and one requires proof beyond a reasonable doubt.[115] Given these variations, it is not clear that SSA, if it examined state guardianship proceedings, would find that they all meet SSA's or the Constitution's standards of acceptable accuracy, efficiency, fairness and respect for beneficiaries.

On the other hand, state guardianship laws do provide articulated standards of incompetence that are applied in proceedings in which more pre-determination procedures are available to beneficiaries than SSA provides in representative payee determinations. If SSA were to refer beneficiaries suspected of being unable to manage their benefits to state adjudications of incompetence, as the VA is authorized to do, what is sacrificed in terms of uniformity of standards might be gained in terms of increased procedural safeguards and decreased administrative expenses for SSA. Funds necessary to defray the cost of conducting guardianship proceedings for indigents might have to be provided by SSA through appropriations, as they are to the VA.

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[111] See, e.g.,, H.R. 5266, A Bill To Protect the Right of Persons to Due Process of Law and Equal Protection of the Laws in Guardianship Proceedings, 100th Cong. 2d Sess. (Sept. 8, 1988) (Introduced by Rep. Pepper); Associated Press, "Guardians of the Elderly: An Ailing System," secoa; reprt (1987) at 11-12. See generally, S. Brakel, J. Parry, and B. Weiner, *The Mentally Disabled and the Law*, 380-385 (1985).

[112] The statutes of Alabama, Louisiana and Mississippi do not require prior notice. And see Frolik, "Plenary Guardianship: An Analysis, A Critique and a Proposal for Reform," 23 ARIZ. L. REV. 599, 637 (1981).

[113] S. Brakel, J. Parry and B. Weiner, *The Mentally Disabled and the Law* 381 (1985).

[114] Associated Press, "Guardians of the Elderly: An Ailing System," Special Report (1987) at 4 and 6.

[115] The Supreme Court has required a clear and convincing standard of proof in state commitment proceedings. *Addington v. Texas*, 441 U.S. 418 (1979).

incompetence, as the VA is authorized to do, what is sacrificed in terms of uniformity of standards might be gained in terms of increased procedural safeguards and decreased administrative expenses for SSA. Funds necessary to defray the cost of conducting guardianship proceedings for indigents might have to be provided by SSA through appropriations, as they are to the VA.

### b. The Adoption of Emancipation As a Determination of Capacity

Similarly, SSA has a blanket policy of paying directly minors who are emancipated under state law, regardless of the actual relationship between the basis for emancipation and competence to handle social security benefits. For example, minors 15- to 18 are assumed to be incapable of managing their benefits, but they are permitted to establish that they may nevertheless qualify for direct payment.[116] SSA's POMS provide that no independent determination of capacity will be made where a 15- to 18-year-old meets certain criteria. Specifically, a minor who has no legal guardian will be assumed to be capable if he or she is individually entitled to disability insurance on the basis of his or her own earnings, is on active duty in the armed forces, lives alone and is self supporting, is a parent also filing on behalf of his or her child, and/or no representative payee is available.[117] Yet, compliance with at least some of these criteria depend on the application of standards developed for unrelated purposes by agencies, such as the Armed Forces, over which SSA has no control. It may or may not be true, that upon independent investigation and evaluation, persons meeting these criteria would usually be found by SSA to be capable of managing their benefits. Unless such a relationship can be supported, the use of these presumptions could be challenged as arbitrary and capricious under the due process clause and section 706 of the APA.

### c. Determinations of Need for a Payee Based on Medical Opinion

Allegations that trigger an investigation into capability include evidence which suggests that the beneficiary may not be able to reason properly, is disoriented, has impaired judgment, is unable to communicate with others, is mentally retarded, is schizophrenic or has organic brain syndrome.[118] However, these indications of incapability are not established as a standard or criteria for a determination of incapability due to mental disability. If incapability is not assumed on the basis of legal incompetence or minority, the POMS provides that SSA must develop evidence of capability and make a specified in SSA's Medical Disability Listings, a determination of incompetency by the VA, and a physician's or psychologist's opinion regarding capability (discussed below) are considered "convincing evidence" upon which a determination of capability or incapability must be based.[120] Again, some of the listed evidence consists of documented determinations by persons outside the agency based on criteria developed for purposes other than assisting vulnerable persons. For example, while persons with Down's Syndrome may be disabled for employment purposes in that they are unable to secure gainful employment in certain circumstances, it is not clear that they are necessarily incapable of handling their benefits in all circumstances. On the other hand, VA determinations of incapability are made for the same general purposes as SSA representative payment and may provide a reasonable basis for similar SSA determinations.

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[116] POMS §GN 00502.040, B, 1040 B.2 (1989).

[117] POMS §GN 00502.040 (1989).

[118] POMS §GN 00502.050, A, 2 (1989).

One evidentiary basis for an incapability determination is "convincing medical evidence" or the opinion of a physician or other health care personnel. While the POMS does not mandate representative payment when convincing medical evidence of incapability is provided, there is a strong implication such payment should be ordered wherever a physician, based on a recent examination, believes the beneficiary is incapable. SSA claims representatives are "always" to obtain convincing medical evidence of incapability if it is available, seeking it first from the beneficiary's personal treating physician or psychologist or the medical officer of a medical facility in which the beneficiary is resident. If neither are available, the beneficiary is apparently advised that he or she will need an assessment, but that SSA is not authorized to pay a fee for completion of its evaluation form, SSA-787. Payment of the fee is to be treated as a matter to be resolved between the physician and the beneficiary.[121] It is not clear what determination is to be made where a beneficiary refuses or cannot afford to pay for a physician's capability determination.[122] Presumably, the claims representative is authorized to collect lay evidence and base a determination upon it.[123] The POMS defines "convincing" medical evidence to mean an opinion from a physician, psychologist or medical officer as to the beneficiary's capacity, which indicates the nature of the beneficiary's mental or physical condition, is based on an examination within 1 year, signed by the person conducting the examination and is consistent with evidence in the file.[124]

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[120] POMS §GN 00502.050, A, 5 (1989).

[121] In disability cases, the claims representative may request the State Disability Determination Service (DDS) to assist in developing information upon which to base incapability determinations by undertaking "appropriate development" or obtaining a SSA-form 787 evaluation from psychiatrists who consult on disability determinations. DDS is not authorized to make a formal capability or incapability determination POMS §GN 00502.050,B,4 (1989).

[122] POMS §GN 00502.050,B,3,a (1989)

[123] POMS §GN 00502.050,B,1,5 (1989).

This acceptance of convincing medical evaluation before other factors have been weighed obviously increases the reliance on the opinion of physicians and may result in overassessments of incapability. If in a physician's opinion a beneficiary in incapable, the SSA will accept the finding as convincing evidence and make a determination for representative payment. However, if the opinion is that the beneficiary is capable, a claims representative may collect lay information upon which to base a determination of incapability.[125] Thus, physician error can be corrected only if the error results in a finding of capability, but not if it results in a finding of incapability. Furthermore, unlike the VA physicians utilized by the VA rating board, physicians relied upon by the SSA are not required to perform any specified tests or evaluations in making their assessment of capability or to have known or treated the beneficiary for any period of time. Indeed, SSA estimates that it will take a physician only 5 minutes to complete the necessary form. In addition, health care personnel are given little information about what the term "incapable" might mean for these purposes or specific criteria upon which to base their opinion. Physicians are asked to complete a form that indicates why the SSA is requesting evaluation. It states:

> Some individuals age 18 or older are not capable of handling their funds or directing others how to handle them to meet their basic needs, so we select a representative payee to receive their checks. Examples of impairments which may cause incapability are senility, severe brain damage or chronic schizophrenia. However, even though a person may need some assistance with such things as bill paying, etc. does not necessarily mean they are incapable of managing their own money.

The form further explains

> By capable we mean the patient:
>
> . Is able to understand and act on the ordinary affairs of life, such as providing for own adequate food, housing, clothing, etc.; and

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[124] POMS §GN 00502.050, A, 5, f and B, 5 (1989). Where there has been no examination within the last year, beneficiaries are to be instructed that they will need such an examination but SSA is not authorized to pay a fee to a physician providing it.

[125] POMS §GN 00502.050, B,1 (1989).

. Is able, in spite of physical impairments, to manage funds or direct others how to manage them.

The form then asks the physician "Do you believe the patient is capable of managing or directing the management of benefits in his or her own best interest?"

A negative answer constitutes "convincing medical evidence" of incapability sufficient to form the basis for an SSA determination of the need for representative payment. Yet, in part because of its brevity, the question is ambiguous and leaves open certain questions such as whether there are ordinary affairs of life, other than the provision of food, shelter and clothing that a beneficiary must be able to understand and act upon to be considered able to manage his or her benefits. The physician is asked to provide a brief summary of findings that lead to the stated conclusion of incapability. However, claims representatives are not instructed by the POMS as to what kind of findings, if any, are necessary to support such a conclusion.

More importantly, it should be remembered that while physicians are expert in determining the functional ability of persons with different mental and physical conditions and in making a prognosis about their probable functional capabilities in the future, they are not expert in determining acceptable levels of functioning in general or in specific circumstances. This is especially true if the physicians have not been informed by evidence or testimony from persons other than the beneficiary about the beneficiary's ability to function in his or her own surroundings. The explanation of the capability determination stated on the medical certification form to physicians is the agency's best effort to date to define the concept and is preferable to the recently revised form. It could become the basis for the promulgation of a standard in SSA regulations and in the POMS.

### d. Determinations Based on Claims Representatives' Opinion.

Only when neither an existing legal determination of incompetence nor convincing medical evidence is available, may the SSA claims representative look to statements made by the beneficiary or other lay persons to establish an adult beneficiary's capability. In that event, claims representatives are instructed to contact the beneficiary and persons who know about his or her circumstances. The statements obtained should detail the facts about the beneficiary's behavior and explain how the impairment affects his or her ability to manage benefits. Claims representatives are instructed not to base their decisions on unsupported allegations by third parties, but to verify the allegations with other sources and interview the beneficiary.[126] The claims representatives are then to decide the capability issue by weighing all the evidence obtained, including evidence of the beneficiary's physical and mental health, living situation, needs, money management skills, education and work history.[127] Although SSA regulations permit the appointment of a payee only where inability to manage benefits is "due to a mental or physical condition," it is unclear what qualifies a claims representative to determine if such a condition exists. Again, sociably unacceptable behavior may well be accepted as evidence of mental disease or defect.

### 3. Other Standards

As discussed above, most states' guardianship statutes contain a two-part definition of legal competence--first, an inability to perform certain functions, such as care of self or responsible decisionmaking, and second that the inability be caused by an uncontrollable mental or physical condition. Similarly, the VA applies a standard of competency that depends both on a finding that the veteran is incapable of handling financial affairs and that the disability is the result of an injury or disease.[128] When a VA field office has reason to believe that a veteran is incapable of handling benefits, the office will conduct a field examination, which includes a face-to-face interview with the beneficiary in every case and other persons with knowledge of his or her situation. If no determination of legal competence has been made by a state court, the field examiner may initiate such a guardianship determination through legal counsel, or it may seek a determination of incompetency by a VA Rating Board, is composed of three persons, one of whom is a physician. In addition to making disability determinations for entitlement purposes, the Rating Board will make a determination of the veteran's competence to handle personal financial affairs. The standard of incompetency applied by the Rating Board is generally stated in regulations to be a lack of capacity to contract or manage financial affairs due to an injury or disease.[129] The regulations do not state what degree of disability is required for such a finding; that is, they do not require such incapacity that the veteran is unable to obtain food, shelter and clothing. The requirement of functional incompetence resulting from injury or disease narrows the definition and excludes findings of incapability based on indiscretion and unusual lifestyles. While the VA regulations are not as refined as those of some state guardianship laws or as they might be to carry out the limited purposes of the fiduciary program, the VA is able to achieve a refined objective by providing "supervised direct payment" to partially impaired beneficiaries. In addition it should be noted that the VA makes findings of partial disability for entitlement purposes unlike the SSA, which makes findings of only total disability. This allowance for partial disabilities may make the incapability question a less difficult one for VA.

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[126] POMS §GN 00502.050, B,5 (1989). Determinations of incapability must be explained on special determination forms, SSA-553, where it is established on the basis of lay evidence or there are inconsistencies in the evidence or where capability is established only because there is no convincing legal, medical or lay evidence or there are contradictions which cannot be resolved. POMS § GN 00502.060, A,2 (1989).

[127] POMS §GN 00502.060, A, 1 (1989).

[128] See 38 CFR §3.353 (1990).

[129] 38 CFR §3.353(d) (1990).

Unlike definitions of incompetence for state guardianship purposes, SSA's concept of incapability expressed in the POMS does not require that the inability to expend benefits in one's own interest be due to a mental or physical defect, although the regulations seem to assume such a causal relationship.[130] The POMS provides only that "[o]rdinarily, SSA will pay benefits to an RP if the beneficiary is incapable of managing or directing the management of benefits and representative payment will serve his/her best interests."[131] There is no express requirement that the inability to manage benefits result from mental or physical impairments. Even the form provided by physicians does not seek information about or mental or physical disabilities other than a single, global assessment of the patient's ability to "understand and act on the ordinary affairs of life. This failure permits claims representatives and health care personnel to base their incapability determinations wholly on their assessment of the prudence of the beneficiaries conduct.

## B. Constitutional Requirements For A Standard

Among the remaining constitutional restraints on grants of legislative authority after the decline of economic substantive due process[132] are first, limitations on delegations of legislative authority to administrative agencies that limit personal rights, and second, prohibitions against vagueness and arbitrariness. However, although due process requires that legislation result from an exercise of judgment rather than arbitrary power, the Supreme Court has been willing to sustain legislation whenever even a hypothetical rationale relevant to a legitimate legislative end can be provided to support it. Thus, an initial inquiry with regard to the representative payee program is whether it is reasonably related to a valid legislative end. A second question is whether Congress has provided sufficient guidance to the agency to permit a court to determine whether its actions are within its grant of legislative authority,[133] that is, whether Congress has provided a standard constitutionally sufficient to direct the agency in the exercise of its rulemaking and adjudicatory discretion affecting individual liberty interests and entitlements.[134] Even if Congress has failed to circumscribe its grant of discretionary authority to SSA, the agency may have sufficiently limited its own discretion, through regulations to which the courts must pay deference, to protect beneficiaries from arbitrary treatment. Finally, SSA's utilization of determinations by other federal and state agencies and private persons raises the further question whether there is an improper delegation of authority from the federal administrative agency to private and other public bodies.

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[130] 20 CFR §404.2001(b) (1990) provides:

> Our policy is that every beneficiary has a right to manage his or her own benefits. However, some beneficiaries due to a mental or physical condition or due to their youth may be unable to do so. Under these circumstances, we may determine that the interests of the beneficiary would be better served if we certified benefit payments to another person as a representative payee.

[131] POMS §GN 00502.040, A (1989).

[132] Since Congress may exercise only the powers enumerated in the Constitution, the representative payee program must be authorized by one of these. The Social Security program itself has been found by the Supreme Court to be an exercise of Congressional authority to spend

While the nondelegation principle was used to strike down some regulatory legislation at the beginning of the New Deal period,[135] the Supreme Court has

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public funds for the general welfare. *Charles C. Steward Machine v. Davis*, 301 U.S. 548 (1937); *Helvering v. Davis*, 301 U.S. 548 (1937). The authority to limit the legal rights of beneficiaries to direct payment can be regarded as "necessary and proper" to the exercise of Congress' spending powers. U.S. Constitution, Article I, section 8, clause. If the general welfare is conceived as the expenditure of federal funds in the interest of beneficiaries, as that interest is determined by the government, then representative payment is necessary and proper to the accomplishment of that end. Such a rationale would not sustain a federal guardianship statute enacted apart from an exercise of the spending power, which sought to implement, on a federal level, the kind of state guardianship protections of all kinds of property--state and private income as well as federal benefits--provided by the states in the implementation of their *parens patriae* powers. However, such a national guardianship scheme might be sustained as an exercise of Congress' authority to regulate interstate commerce expansively defined.

[133] Courts have held some delegations of discretion to administrative bodies without standards to be violations of the Fourteenth Amendment's due process clause. See, e.g.,, *Hornsby v. Allen*, 326 F.2d 605 (5th Cir. 1964); *Holmes v. New York Housing Authority*, 398 F.2d 262 (2d. Cir. 1968). S. Breyer and R. Stewart, Administrative Law and Regulatory Policy 383-385 (2d ed. 1985).

[134] See *Carey v. Quern*, 588 F.2d 230 (7th Cir. 1978); *White v. Roughton*, 530 F.2d 750 (7th Cir. 1976); *Baker-Chaput v. Cammett*, 406 F. Supp. 1134 (D. N.H. 1976).

[135] *Panama Refining Co. v. Ryan*, 293 U.S. 388 (1935); *A.L.A. Schecter Poultry Co. v. United States*, 295 U.S. 495 (1935); *Carter v. Carter Coal Co.* 298 U.S. 238 (1936).

not invalidated a federal statute because of an excessive delegation of legislative power to an executive agency since 1937.[136] The concept has been utilized since simply to require Congress to lay down some intelligible legislative policy to guide the exercise of delegated authority to the executive,[137] to support a narrow construction of legislative grants of administrative authority and to uphold delegations of authority when such guidance is provided.[138] However, when fundamental individual liberties are at stake, the courts have demanded a "clear statement" of legislative purpose to limit the scope of constitutionally permissible choice available to the agency.[139] According to Professor Bernard Schwartz:

> There is a personal rights-property rights dichotomy here similar to that prevailing in most areas of constitutional law today. General grants of authority, limited only by very broad standards, are permissible for regulation of property rights; but other rights, involving personal liberties, may be regulated only pursuant to acceptable defined standards. In the field of personal rights, the standards requirement still has vitality despite the post-*Panama* and *Schechter* federal...cases.[140]

Thus, the Supreme Court has given some indication that more Congressional guidance in the form of standards may be required where an agency is given discretion to penalize individual activity as opposed to discretion to regulate business.[141] SSA's determination to deprive an individual of control over benefits, although intended to be protective, infringes on important individual liberty interests and may have a penalizing effect. Although concerns for accountable decisionmaking which underlie the antidelegation and "clear statement" principles would seem to require Congress to provide some guidance for SSA discretion in determining the need for representative payment, it is more likely that given the doctrinal weakness of the delegation principle, those concerns would find expression in the application of due process prohibitions against vagueness and arbitrary agency action.

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[136] See generally, Aranson, Gellhorn and Robinson, "A Theory of Legislative Delegation," 68 CORNELL L. REV. 1 (1982). The decline of the delegation doctrine was due in part to judicial recognition of the fact that the nature of the subject matter of regulation, such as price regulation, did not permit the establishment of detailed and enduring policy. It is sometimes politically infeasible for Congress to make detailed policy choices itself, and courts are not institutionally well suited to determine the degree of specificity desirable or possible with regard to certain matters.

[137] *National Cable Television Assn. v. United States*, 415 U.S. 336 (1974); B. Schwartz, *Administrative Law*, §2.6 (2d ed. 1983). For a suggestion that the nondelegation principle imposes meaningful restraints on Congressional delegations of authority to administrative bodies see the opinions of Justice Rehnquist in Industrial *Department AFL-CIO v. American Petroleum Institute*, 448 U.S. 607 (1980) and *American Textile Manufacturers Institute v. Donovan*, 452 U.S. 490 (1981)(dissenting).

[138] J. Nowark, R. Rotunda and J. Young, *Constitutional Law* 150 (3rd ed. 1986). *Lichter v. United States*, 334 U.S. 742 (1948); *Yakus v. United States*, 321 U.S. 414 (1944).

[139] See e.g., *Kent v. Dulles*, 357 U.S. 116 (1958); *Schnider v. Smith*, 390 U.S. 17, 26-27 (1968). B. Schwartz, *Administrative Law* , §2.9 (1984); Stewart, "The Reformation of American Administrative Law," 88 HARV. L. REV. 1669, 1680-1681 (1975).

[140] Schwartz, *Administrative Law* 50 (2d ed. 1984).

It might be argued that the authority granted to the Secretary by sections 205(j) and 1631 to deprive social security beneficiaries of the legal right to control the expenditure of their benefits when it is in their "interest" to do so is too vague to prevent its arbitrary exercise of agency discretion or to put beneficiaries on notice of the circumstances under which such action can be taken. Life, liberty and property interests[142] may not be diminished pursuant to a statute whose terms are so vague and uncertain that a reasonable person cannot determine their meaning.[143] While the due process prohibition against the enforcement of vague statutes is applied most often to criminal statutes and statutes limiting the freedom of expression, the concept embodies concerns about fairness raised by other due process principles such as those prohibiting arbitrariness.[144] As the Supreme Court noted, a vague law may delegate "basic policy matters to policemen, judges and juries for resolution on an ad hoc and subjective basis, with the attendant dangers of arbitrary and discriminatory application."[145]

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[141] See e.g., *Fahey v. Mallonee*, 332 U.S. 245 (1947).

[142] See discussion of constitutionally protected liberty and property interests, at notes 244 to 248 *infra*.

[143] *Connally v. General Construction Co.*, 269 U.S. 385 (1926); *Lanzetta v. New Jersey*, 306 U.S. 451 (1939); L. Tribe, *American Constitutional Law* 684 (2d ed. 1988).

[144] *Soglin v. Kauffman*, 418 F.2d 163 (7th Cir. 1969). The appellate court stated:

> Defendants argue that "misconduct" represents the inherent power of the University to discipline students and that this power may be exercised without the necessity of relying on a specific rule of conduct. This rationale would justify the ad hoc imposition of discipline without reference to any preexisting standards of conduct so long as the objectionable behavior could be called misconduct at some later date.... The use of "misconduct" as a standard in imposing the penalties threatened here must ...fall for vagueness. The inadequacy of the rule is apparent on its face. It contains no clues which could assist a student, an administrator or a reviewing judge in determining whether conduct not transgressing statutes is susceptible to punishment by the University as "misconduct." Cf. *Boyce Motor Lines v. United States*, 342 U.S. 337 (1952).

Yet, in an area analogous to representative payment, state civil commitment and conservatorship laws have been challenged on the ground that the legislative standards authorizing these deprivations of liberty were unconstitutionally vague and have been upheld. In *Estate of Chambers*, a California Court of Appeal upheld a state statute which authorized the appointment of a conservator of the property of a person found to be "gravely disabled," defined as a condition in which "a person, as a result of a mental disorder, is unable to provide for his basic personal needs for food, clothing or shelter."[146] The court found that the statute was sufficiently precise because it required a finding of a mental disease or defect and a finding that the person was unable as a result of the disability to provide for his or her basic personal needs.[147] The statute was thus sufficiently definite to give fair notice of the proscribed conduct to the proposed conservatee and to prevent the appointment of conservators upon a finding of merely unusual or nonconformist lifestyles. Section 205(j) requires no such findings, and on its face would permit the Secretary to require representative payment because of a beneficiary's bizarre lifestyle or unpopular practices. However, SSA has issued regulations which could be interpreted as narrowing its discretion to cases in which bizarre lifestyle is the product of or evidence of mental or physical disease or defect, although SSA regulations use the term mental or physical "condition." Therefore as applied, the statute probably may avoid constitutional prohibitions against vagueness.

Moreover, some authorities contend that concerns about uncontrolled agency power should not find expression in either the vagueness and nondelegation doctrines but in protections against arbitrary agency action. Thus, Professor Kenneth Culp Davis argues, courts should affirmatively assert that Congressional delegations are lawful as long as the broad legislative purpose is discernible and as long as protections against arbitrary power are provided by the agency.[148] He acknowledges that the risk of arbitrary or unjust action is much greater from informal discretionary action, of the kind taken when SSA makes incapability determinations, but even there the protection afforded by procedural safeguards is likely to be more effective than protection from legislative standards. Consequently, Davis argues in favor of administrative safeguards, including standards, rather than statutory safeguards.[149]

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[145] *Grayned v. Rockford*, 408 U.S. 104, 108-109 (1972). See generally, S. Stone, L. Seidman, C. Sunstein, and M. Tushnet, *Constitutional Law* 1043-1045 (1986).

[146] *Estate of Chambers*, 71 Cal. App. 3d 277, App. 139 Cal. Rptr. 357 (Ct. of App., 1st Dist. 1977); Cal. Welfare and Institutions Code, §5008 (h) and (l) (Stats. 1967, ch. 1667 at 4074, operative July 1, 1969).

[147] The court rejected the conservatee's argument that the statutory requirement of a finding of mental disorder did not save the statute from vagueness. The conservatee had argued that the definition of mental disorder itself ultimately turns on behavioral deviations from social norms and is therefore inherently subjective. Such unclear and vague medical concepts of mental disorder cannot serve as constitutionally definite legal criterion it was contended.

Finally, SSA's interprative narrowing of its statutory authority must be accepted as controlling by a court asked to determine the statute's constitutionality and the regulation's legality. Under the Supreme Court's *Chevron* doctrine, judicial review of SSA's "incapability" regulations is limited to a determination of whether the regulations are authorized by Congress and are not arbitrary or capricious.[150] As the Supreme Court observed in *Sullivan v. Zembley*, a recent decision invalidating SSA regulations governing the eligibility of children for SSI disability payments, "since the Social Security Act expressly grants the Secretary rulemaking power, our review is limited to determining whether the regulations promulgated exceeded the Secretary's statutory authority and whether they are arbitrary and capricious."[151]

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[148] K. Davis, 1 *Administrative Law Treatise*, 211-14 (2d ed. 1978).

[149] Professor Davis states:

> The courts should continue their requirement of meaningful standards, except that when the legislative body fails to prescribe the required standards for discretionary action in particular cases, the administrators should be allowed to satisfy the requirement by prescribing them within a reasonable time..... Legislative bodies should clarify their purposes to the extent that they are able and willing to do so, but when they choose to delegate without standards, the courts should uphold the delegation whenever the needed standards to guide particular determinations have been supplied through administrative rules or policy statements.

Id. at 213. Thus, if a suit were brought challenging the lack of a standard of beneficiary interests in sections 205(j) and 1631, Davis would argue that rather than invalidate the statute for a failure to provide standards, when standards are lacking to guide the exercise of discretionary power in individual cases, "courts should in appropriate circumstances require administrative rulemaking to provide the standards...." *Id.* In keeping with this analysis of constitutional requirements, courts have held that where both legislative and administrative standards are lacking to guide administrative discretion to take disciplinary or regulatory action, due process requirements are not met. See e.g., Soglin v. Kauffman, 418 F.2d 163 (7th Cir. 1969); Hornsby v. Allen, 326 F.2d 605 (5th Cir. 1964).

[150] *Chevron U.S.A. Inc., v. Natural Resources Defense Council* provides an often-cited two-step framework for judicial review of administrative interpretations of statutes. 467 U.S. 837 (1984). It requires the court to first determine whether "Congress has directly spoken to the precise question at issue." If the intent of Congress is clear and unambiguous, its expressed intent must be given effect by the agency. If, however, the "precise question" has not been addressed by Congress or if Congressional intent is unclear or ambiguous, the court must defer to the agency's interpretation of the statute unless it is "arbitrary, capricious, or manifestly contrary to the statute." *Id.* at 842-44. For example an HHS regulation defining "unemployment" for purposes of federal-state welfare assistance was found controlling where it was found consistent with federal authorizing statute. *Bratton v. Francis*, 432 U.S. 416, 428-29 (1977).

Thus, SSA's regulations defining beneficiary interest for the purposes of representative payment to mean the physical and mental ability to manage benefits must be given deference, unless they are manifestly contrary to the purposes of the Act. That is, if the regulations are based on a permissible (though not the only permissible) construction of the statute, they must be upheld. As discussed below, since there are several possible legislative objectives to be furthered by authorizing the Secretary to make representative payment, it would seem difficult to contend that SSA's incapability regulations are "manifestly contrary to the statute." Whether they can be regarded as arbitrary is a different matter.

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[151] 58 U.S.L.W. 4177 (Feb. 2, 1990) citing Bowen v. Yuckert, 482 U.S. at 145 (quoting Heckler v. Campbell, 4;61 U.S. 458, 466 (1983). In the case of representative payment, SSA is authorized, but not required, by the Act to make rules and regulations to carry out provisions of Titles II and XVI with regard to the appointment of a payee. 42 U.S.C.§405(a) (made applicable to Title XVI by section 1383(d)(1) reads:

> The secretary shall have full power and authority to make rules and regulations and to establish procedures, not inconsistent with the provisions of this subchapter, which are necessary or appropriate to carry out such provisions, and shall adopt reasonable and proper rules and regulations to regulate and provide for the nature and extent of the proofs and evidence...to establish the right to benefits hereunder.

If the phrase "right to benefits" is interpreted to mean only an entitlement to benefits, the Secretary would not seem to be required to adopt procedures for establishing a right to direct payment. Although the Secretary has issued regulations pertaining to representative payment, in light of the reliance on the undefined concept of "capability," it can be argued he has not issued regulations providing "for the nature and extent of the proofs and evidence...to establish the right" to direct benefits.

## C. Statutory Directives

### 1. The Social Security Program And Purposes of Representative Payment Authority

There are at least three possible legislative policies that the 1939 authorization for representative payment could have been intended to further and which, therefore, should circumscribe the Secretary's discretionary authority to promulgate regulations governing representative payment and certify payment to payees. Although they are related, overlapping and difficult to parse, these policies include the following:

First, Congress may have intended to assist beneficiaries who needed help managing their benefits, by providing a mechanism through which decisions about the expenditure of federal funds in the best interest of the beneficiary could be made. The appointment of representative payees can be viewed as a way of maintaining decentralized decisionmaking with regard to benefit expenditure, in that each payee must determine the best expenditure of benefits on behalf of the incapable beneficiary in his or her particular circumstances. As such, the government merely provides the legal means to permit others to decide what expenditure of benefits would be in the best interest of incapable beneficiaries.

Second, in providing for representative payment, Congress also may have intended to assure the public that the federal government would assume responsibility for seeing that federally provided benefits would be expended for the purposes underlying the social security insurance and assistance programs. The Secretary is authorized to pay Title II benefits to a payee only "if the Secretary determines that the interest of any individual under this title would be served...." The authorization given to the Secretary to act only in accordance with his or her own determination of the beneficiary's interest, indicates an intention on the part of Congress to benefit and protect only the interests of the beneficiary that the Secretary decides are worthy of protection, not necessarily the beneficiary's interests as the beneficiary, a state court or a representative payee might perceive them. Viewed in this light, representative payment provides a mechanism for centralized government decisionmaking with regard to benefit expenditure. Since it authorized indirect payment for legally competent as well as incompetent individuals, Congress may have sought to ensure that federal benefits are expended in accordance with a standard of responsibility other than that adopted by some state guardianship laws. Thus, apart from any intention to benefit incapable persons entitled to social security payments, Congress may have intended to assure taxpayers that the funds they provide to old, disabled and poor people will be used to provide benefits of which the public would approve, much as Congress has done by establishing in-kind benefit programs such as Medicaid and public housing. This reading of Congress' intention is supported by the language of section 1631 of Title XVI of the Act which, until 1990, authorized the Secretary to pay SSI benefits to spouses or other persons interested in or concerned with the welfare of a beneficiary "if the Secretary deems it appropriate." The Secretary's authority under this section was not conditioned on a finding that representative payment was in the interest of the beneficiary, but only that it was "appropriate" for whatever reasons the Secretary might have.[152] This goal is also in keeping with an extension of the concept of "incapability" beyond the limits of legal incompetence.[153] If Congressional purpose were found to have been the responsible expenditure of federally provided benefits in the sense of publicly acceptable expenditure, the Secretary would seem to have greater latitude in setting standards for representative payment than if the only goal were furthering the interests of the beneficiary, which might or might not coincide with publicly accepted expenditure in any given situation.[154]

Thus, a second Congressional objective may have been not only to centralize but also to federalize and make more uniform decisions about how federal benefits should be spent.[155] Section 205(k) immunizes the Secretary from liability for paying benefits to persons adjudicated incompetent in state proceedings by providing that direct payment to a legally incompetent person pursuant to the authority granted by section 205(j) shall be complete satisfaction of the Secretary's obligation to make payment.[156] Thus, section

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[152] In 1984, the section was amended to provide that payments to a person other than the eligible individual or spouse must be made on the basis of an investigation and on the basis of adequate evidence that such determination is "in the interest of the individual or spouse entitled to such payment." 42 U.S.C. §1383(a)(2)(B)(1988).

[153] With regard to the same definitional problem encountered under guardianship statutes see *Partello v. Holton*, 9 Mich. 372 (1890), and with regard to the difficulties of definition based on psychiatric diagnosis see *Blocker v. United States*, 288 F.2d 835 (D.C. Cir. 1961) (Burger concurring).

[154] If the only goal were to provide assistance to beneficiaries, the Secretary might be thought required to provide payees to those beneficiaries who request them. However, SSA guidelines make it clear that it will not provide a payee to a competent adult beneficiary simply because the beneficiary desires one. POMS §GN00502.040, B, 4 (1989).

[155] The Court of Appeals noted in *Briggs v. Sullivan* that the district court found that "the public interest in wisely spending public funds" outweighed the incapable beneficiary plaintiffs' interest in direct payment of benefits to avoid the hardships occasioned by SSA's suspension of benefits where no payee could be found. 886 F.2d 1132 (9th Cir. 1989). The Court of Appeals did not agree.

[156] 42 U.S.C. §405(k) (1988). In addition, payment made to a legally incompetent person prior to December 31, 1939 and any payment made after December 31, 1939 to an incompetent person where the Secretary has no knowledge of the incompetency prior to certification of

205(k) would prevent the estate of an incompetent suing the Secretary to recover direct payments made to a legally incompetent beneficiary rather than his or her guardian. While Congress may have intended to protect the public purse against such claims, the provision also protects federal prerogatives with regard to the appropriateness of making direct payments to legally competent and incompetent beneficiaries, rather than abdicate such prerogatives to the states. It is presumably based on the premise that social security benefits are federally provided funds, the expenditure of which should be a federal, not a state, responsibility.

Finally, although there is little evidence of it in the express language of the statute or its sparse legislative history, Congress may have empowered the Secretary to appoint a payee to expend federal benefits out of deference to the autonomy interests of beneficiaries. When persons are recognized to have substantive liberty and property interests, such as entitlements to social insurance and welfare benefits, the Constitution protects them against deprivation without due process.[157] If individuals become incompetent or incapable of exercising their rights with regard to protected interests, courts, at least in some circumstances, have recognized the principle of substituted judgment and have appointed surrogate decisionmakers to make dispositions, not in accordance with the best interests of the incompetent as that interest is determined by others, but to the extent possible, in accordance with the judgment the incompetent would have made if competent.[158] This principle suggests that the source of rights exercised by guardians is not the *parens patriae* powers of the state alone, but the constitutionally protected rights of the individual whose liberty or property is at issue, as well. Such a rationale for representative payment would militate in favor of broad powers for representative payees and the establishment of procedures through which substituted judgments might be rendered.[159]

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payment are to be considered complete settlement and satisfaction of any claim to payment. 42 U.S.C. §405(k). The negative implication of the section would seem to be that if after December 31, 1939, payment is made to a person known by the Secretary to be legally incompetent or not pursuant to §405(j), payment will not be a complete settlement and satisfaction of any claim to payment.

[157] *Goldberg v. Kelly*, 397 U.S. 254 (1970); *Mathews v. Eldridge*, 424 U.S. 319 (1976).

[158] E.g., *In re Quinlan*, 70 N.J. 10, 355 A.2d 647 (1976); *Matter of Conroy*, 98 N.J. 321, 486 A.2d 209 (1985). Where the incompetent has expressed no intention with regard to the matter in question some courts have adopted a reasonable man standard and will order what a reasonable person in the incompetent's position would intend under the circumstances. Rohan, "Caring for Pereson Under a Disability: A Critique of the Role of the Conservator and the Substituted Judgment Doctrine," 52 ST. JOHN'S L. REV. 1 (1977).

[159] Perhaps related to the effectuation of beneficiary rights is Congress' possible intention to facilitate the expenditure of social security benefits by eliminating defenses to the enforcement of

The legislative histories of sections 205(j) and 1631 are sparse with regard to the purposes Congress hoped to achieve when it granted the Secretary authority to make representative payment. Thus, it may be impossible to separate these hypothetical Congressional motives and determine which purposes actually motivated Congressional action. However, it can be argued that furtherance of any one of the possible goals, though each is somewhat distinct, is sufficient to support an administrative determination that representative payment is appropriate.[160] Finally, it can also be argued that whatever the legislative purpose in enacting representative payee authority in 1939, Congress has since ratified, through amendments to the Act, administration of the program primarily in accordance with the second objective (i.e., in the interest of beneficiaries as determiend by SSA and not to protect the government from liability or to ensure taxpayers their expenditure preferences).

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contractual relations which originate in questions of competence. Contracts have long been held voidable when one party is determined not to have had the mental capacity to enter the relationship voluntarily, either because he or she could not understand the nature of the transaction or could not act in accordance with that understanding. Farnsworth, *Contracts* §4.6 (1982); Williston, *Contracts* §250-51, 156 (1956). Similar rationale support the incapacity of children to enter contracts. Landlords, merchants, and others who deal with social security beneficiaries run the risk, like those who deal with the general public, that such defenses will be raised to the enforcement of their transactions. Representative payment reduces such risk, by assuring people who deal with social security beneficiaries that those determined incapable of contracting are precluded from expending their benefits. Thus, if beneficiaries are found to lack the capacity to exercise their right to make contracts to expend benefits, that right must be exercised, if at all, by a surrogate to protect the interests of those who engage in transactions in which benefits are expended. If this purpose were among those representative payment was intended to serve, the test of capability should reflect the purposes served by concepts of capability to contract, rather, for instance, concepts of minimal functional competence.

[160] See, e.g.,, *Ferguson v. Skrupa*, 372 U.S. 726 (1963). Determining legislative intent is, of course, problematic, for legislation is the result of a process in which different persons, committees, and chambers act with a variety of motives. For purposes of constitutional analysis, the Supreme Court will find legislation rational if the Court can find any rational goal or policy to be furthered by it, regardless of whether the policy can be found to have motivated the legislation in fact.

## D. Compliance With the Administrative Procedure Act

### 1. Rulemaking

Inherent in the grant of discretion to an agency is an agency's responsibility to make rules indicating how it has chosen to exercise that discretion.[161] However, neither the Constitution nor the Social Security Act require SSA to follow particular procedures when it engages in rulemaking.[162] The APA does contain such requirements. While the APA does not require that the agency promulgate rules to carry out legislative directives, it does require that certain kinds of rules be promulgated in certain ways. The SSA's statements contained in regulations and in the POMS regarding the representative payee program are "statements of general applicability and future effect" designed to implement sections 205j and 1631 and thus can be characterized as "rules" under the APA.[163] The APA requires that some rules be promulgated in accordance with section 553's notice-and-comment requirements for informal rulemaking.[164] Although section 553 exempts from informal rulemaking requirements "matter[s] relating to...benefits,"[165] HHS has waived this exception.[166] Other rules, such as interpretive rules, statements of general policy or rules of procedure, need not be propounded through informal rulemaking.[167] Thus, if SSA statements pertaining to the incapability standard contained in the POMS but not SSA regulations are regarded as an interpretative rulings, they need not be formulated in accordance with section 553 procedures. However, if such POMS provisions are regarded as an agency statement of general applicability and future effect involving benefits, they must be promulgated in accordance with section 553 requirements and SSA's waiver.[168] By and large, with the exception of its rules regarding the suspension of benefits, discussed below, the POMS elaborates upon the general statements of policy contained in SSA representative payee regulations promulgated in compliance with informal rulemaking requirements.

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[161] In *Morton v. Ruiz*, 415 U.S. 199 (1974), the Supreme Court noted that "agency power to makes rules that affect individual rights and obligations carries with it the responsibility not only to remain consistent with government legislation, but also to employ procedures that conform to law. No matter how rational or consistent with Congressional intent a particular decision might be, the determination of eligbility cannot be made on an ad hoc basis by the dispenser of funds." As noted above, the SSA has not issued a rule expressly establishing a standard of incapability to be applied by the agency. SSA regulations, adopted through notice and comment rulemaking, stating what evidence of incapability will be accepted as conclusive by the agency, is not a standard that provides guidance as to the type of evidence that is or is not relevant to such determination. SSA has chosen not to establish such a standard, either through informal rulemaking or by an interpretive ruling. While agency policy with regard to such a standard could be formulated in case-by-case adjudications, SSA has indicated that case-by-case incapability determinations made by claims representatives and ALJs with regard to capability are not to be considered general statements of agency policy of future effect or precedent.

[162] Schwartz, *Administrative Law*, §4.8 (1984).

[163] 5 U.S.C. §551(4) (1988).

[164] Agency action regulating future conduct, whether of general or particular applicability, is considered a "rule" by the APA. Such regulation can be undertaken by an agency either through rulemaking or adjudication, that is, in either a legislative or judicial mode. 5 U.S.C. §551 (1988). Adjudication is regarded as a residual category of agency actions that are not rulemaking. Under the APA, adjudication can be either formal (when a hearing is required) or informal. The requirements for most rulemaking are set out in Section 553 of the APA. This section applies to "informal rulemaking," establishing minimal procedures including public notice in the Federal Register and an opportunity for public comment, when an agency formulates a rule or statement of future effect that is not required by statute to be "on the record." In the terms of the APA, such statutes call for "formal rulemaking," the procedural requirements for which are spelled out

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under the Act. 5 U.S.C. §§556 and 557 (1988). Sections 556 and 557 establish trial-like procedural requirements for on-the-record hearings including requirements that the rule adopted be supported by substantial evidence, that the hearing be conducted by an administrative law judge or agency member, that the parties be allowed to present oral and written testimony and cross-examine witnesses and present proposed determinations of fact and law and exceptions to the recommended determinations of the tentative agency decisions. The trial-like procedures required for formal rulemaking are considered undesirable for many administrative law purposes and are not widely used.

[165] 5 U.S.C. §553(a)(2)(1988).

[166] 36 Fed. Reg. 2532 (1971). The Department of Health and Human Services considered rescinding its waiver in 1982. 47 Fed. Reg. 26,860 (June 22, 1982). The HHS waiver does not apply to interpretative rules and policy statements. That is, HHS has not waived the section 553 exception for interpretative rules and general policy statements.

[167] 5 U.S.C. §553(b)(3)(1988). Policy statements are defined as statements issued by the agency to advise the public of the agency's construction of the statute and rules it administers. Attorney General's Manual on the Administrative Procedure Act, 30, n. 3 (1947). Substantive rules have been defined as rules issued pursuant to statutory authority which compel compliance and affect individual rights and obligations. Schwartz, *Administrative Law*, §4.6 (1984). Interpretive rules, on the other hand, represent only the agency's view of the law and do not by their terms affect rights and obligations. *Id.* §4.7. The distinction between the two types of rules has been characterized by the United States Court of Appeals for the District of Columbia as "enshrouded in considerable smog." *General Motors Corp. v. Ruckelshaus*, 742 F.2d 1561, 1565 (D.C. Cir. 1984).

[168] APA notice-and-comment requirements do not apply when the agency makes a finding that APA procedures would be "impractical, unnecessary or contrary to public interest." SSA has not made such an finding with regard to its representative payee policies, and, in fact, SSA regulations governing the appointment of representative payees have been published in the Federal Register after notice and comment.

## 2. Publication

Even where the APA does not require rulemaking procedures be followed by an agency, such as in the case of interpretative rules and general statements of policy, section 552 does require SSA to publish in the Federal Register such interpretative and policy statements as well as substantive rules of general applicability adopted as authorized by law.[169] General statements of policy include statements issued by an agency to advise the public prospectively of the manner in which the agency proposes to exercise a discretionary power, such as that authorized by sections 205(j) and 1631 of the Social Security Act. To the extent that such statements appear in the POMS and are not included in SSA representative payee regulations published in the Federal Register, they violate the requirements of section 552, and thus "a person may not in any manner...be adversely affected by a matter required to be published in the Federal Register and not so published."[170] Section 552 does not require publication of rules of particular applicability, such as individual representative payee determinations, but if they are not published, they cannot be regarded as statements of binding agency policy.[171] It is SSA practice to publish some agency decisions in the agency's Office of Hearings and Appeals Law Reporter with the express admonition that they are not published "to express opinions or attempt to influence" agency action or to be considered authority which can be cited or an expression of official agency policy.[172] Since SSA does not consider such decisions to be precedent, they cannot be regarded as rules.

The SSA regulations appearing at 20 CFR 404.2001 et seq. and 416.600 et seq. pertaining to the representative payee program meet the publication requirements of APA section 552. However, while the regulations do, as they are intended to, "explain the principles and procedures that we (SSA) follow in determining whether to make representative payment," they do not state what the agency means by "incapable" or "unable" to manage benefits, and thus may not accomplish the purpose of section 552--requiring agencies to inform the public of their rules and policies so that private affairs can be ordered accordingly.

## 3. Reasonableness

While SSA regulations and guidelines meet the rulemaking and publication requirements of the APA, their failure to provide an incapability standard may defeat the purposes of APA rulemaking and publication requirements in that they permit arbitrary agency action. In the absence of either a published rule defining incapability or a body of adjudication establishing agency policy regarding incapability, determinations made by claims representatives that certain beneficiaries are incapable might be challenged as arbitrary and capricious and therefore violate section 706 of the APA. Although it does not require that all agency determinations be made in accordance with standards embodied in rules and regulations, section 706 requires agencies to render decisions that are not arbitrary and capricious or an abuse of discretion and that are within statutory limitations and authority.[173] Section 706 has been interpreted to apply to informal agency action and to require that the agency act reasonably within the confines of congressionally intended policy as well as express statutory limitations.[174] It is not the conclusion of this study that a challenge to a representative payee determination, on the ground that the agency's discretion is not properly circumscribed by legislative directives or agency rules, would necessarily be successful. However, an argument could be made that applicable statutory, regulatory and interpretative rules are not sufficiently definite to safeguard beneficiaries against arbitrary agency action.

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[169] 5 U.S.C. §552(a)(1)(D) (1988).

[170] *Id.*

[171] Id; *Donovan v. Wollaston Alloys, Inc.*, 695 F.2d 1 (1st Cir. 1982)

[172] OHA, Law Reporter, preface (April 1989).

Apart from the requirements of the APA, SSA may find that it is to its advantage to set standards through rulemaking as a matter of sound administrative practice. In earlier reports, the Conference has recommended that "[a]gency policies which affect the public should be articulated and made known to the public to the greatest extent feasible."[175] As one commentator has noted, the call for the articulation of agency policy through rulemaking and publication is made for several reasons. Standards limiting agency discretion provide guidance to persons affected by it, provide legislatures and courts with information necessary to review and evaluate agency policies, permit agency supervisors to control the actions of subordinates, and provide persons who may be adversely affected by agency action a more meaningful opportunity to participate in individual decisionmaking.[176] The promulgation of capability standards, even internally and without public notification, would improve the accuracy, consistency and efficiency of SSA's decisions on payee matters. The promulgation of those standards through public notice and hearing procedures that permit affected persons to participate in the rulemaking process would promote perceptions of agency fairness, respect for individuals and rational private ordering. Finally, SSA may find that with an express definition of incapability to guide claims representatives and health professionals in their determinations of the need for a payee, the number of beneficiaries provided payee services would be decreased, as would SSA's oversight and monitoring responsibilities. While establishing such a definition through informal rulemaking involves some additional expenses for the agency, they are one-time costs which are relatively small compared with the magnitude of the program.

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[173] 5 U.S.C. §706(A) and (C) (1988). *Overton Park v. Volpe*, 401 U.S. 401 (1970).

[174] *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.* 467 U.S. 837 (1984). See generally, Schwartz, *Administrative Law*, §§10.13 - 10.17 (2d d. 1984).

[175] Conference Recommendation 71-3: 1 CFR section 305.71-3 (1989). See generally, Diver, "Agency Articulation of Policy," Report to the Administrative Conference of the United States (1982) and Diver, "The Optimal Precision of Administrative Rules," 93 YALE L. J. 65 (1983).

[176] Diver, supra, note 177 at

The federal courts need not defer to an agency's interpretation of the Constitution and its requirements. For purposes of constitutional due process analysis, a federal court must first determine whether the agency has promulgated regulations that are within its statutory authority, and second, decide whether such regulations provide sufficient safeguards against arbitrary action to meet constitutional standards. Thus the inquiry into arbitrariness directed by *Chevron*, the APA's section 706 prohibition against arbitrary agency action, and the Constitution's due process clause would seem to coalesce. It can be argued that in the absence of a definition of "incapability" or explanation of what is meant by the "ability to manage benefits," SSA's procedures are not adequate either to protect beneficiaries against arbitrary action by claims representatives and health care professionals or to permit them to order their affairs so as to avoid indirect payment of benefits.

## E. Administrative Mechanisms for Applying a Standard of Need

There are at least four mechanisms SSA might use to apply an incapability standard once it is developed. While they are discussed briefly here in the hope of stimulating agency consideration, a full exploration of their feasibility and desirability is beyond the scope of this study.

First, SSA could forego all capability determinations and rely wholly on state guardianship and conservatorship determinations which it might initiate in the case of persons thought to be incapable of managing their benefits but who have not been declared incompetent in a state adjudication. As under the present system, the abdication of adjudicative responsibility to state courts would result in the effective adoption of state standards and procedures which may or may not meet SSA approval. Thus, even under the current system, SSA should designate those states whose guardianship laws meet federally established minimum standards and permit or encourage the initiation of guardianship proceedings to determine the need for a payee in those states.

The VA initiates guardianship proceedings through its general counsel's office when a fiduciary cannot be found and VA bears the cost of participating in these proceedings through counsel. However, since full guardianship powers often exceed those needed by a representative payee, SSA should seek the authority to grant only partial guardianship powers to the court-appointed guardian, as is permitted by an increasing number of states.

While state guardianship proceedings are not without critics, utilization of such procedures would provide beneficiaries more extensive procedural safeguards than are currently afforded social security beneficiaries in SSA capability determinations, and would require the bonding of payee-guardians and accountings to the court. However, these requirements may discourage people from acting as payee-guardians, increasing SSA's current difficulty in finding available payees. State guardianship procedures ultimately cost more than current SSA procedures, and while the bulk of the expense would fall on state budgets, beneficiaries would share some of the burden, such as increased costs of representation before a court, the payment of court-approved fees to guardians and the likely scarcity of persons willing to be payee-guardians for the small amount of social security funds at issue. Many of these tasks would fall on appointed public guardians in states which provide those services. Public guardianship services, too, have been criticized as underfunded, overworked and impersonal, although such shortcomings may be better dealt with on the state and local level, particularly if federal assistance were provided through a state-federal grant program. Furthermore, this option simply shifts the obligation to find a payee from SSA to the probate courts, which have no more resources available to locate or develop payees than does SSA. SSA initiation of and deference to state guardianship, coupled with federal funding of the development and state licensure of state payee services, might provide a viable alternative to the present wholly federal system.

Second, like the Veterans Administration, SSA could develop within the agency the expertise to make capability determinations. VA's rating board consists of three members, one of whom is a physician, and is assisted by professional health specialists, usually employed in VA hospitals. Its determinations are subject to review by a hearing examiner and appeal to the Board of Veterans Appeals. Similar bodies established on a local or regional basis could be used to make SSA capability determinations based on a face-to-face interview with the beneficiary where possible and a written record including functional assessment, interview notes, and statements from other interested parties. Such an inhouse capacity to make SSA capability determinations would promote consistency and the development of expertise over time.

Third, SSA could utilize the same state disability determination services (DDS) used to make initial disability determinations, with appeals to administrative law judges (ALJs) and the Appeals Council.[177] Current guidelines provide that claims representatives may request state DDS assistance in obtaining medical evidence of incapability and that a state DDS may undertake to develop evidence of capability whenever it detects a capability issue.[178] At the present time, a DDS sometimes indicates in the files that it provides to SSA the need for a capability determination on the basis of its evaluation of the disability claims. SSA offices also seek DDS information for the purpose of making capability determinations.[179] If state DDS's were utilized more fully, SSA should require that their procedures be adapted to facilitate functional assessments of financial management ability and personal interviews, as well as medical examinations when necessary to evaluate and predict beneficiary functioning.[180] Capability evaluations could be made routinely by DDS offices in certain kinds of disability cases in which incapability is likely. Other Title II and Title XVI beneficiaries would have to be referred to DDS for evaluation at the discretion of the local claims representative.

Finally, SSA could designate and train certain agency personnel to gather functional information about beneficiaries for whom a payee has been proposed. Such trained personnel might be located in each local office to handle all representative payee matters presented there. These personnel could conduct face-to-face interviews with beneficiaries and payee applicants, administer functional assessment instruments and communicate with other interested parties including payee applicants, physicians and witnesses. When necessary to evaluate or predict future capability, the designated personnel should be able to request a medical examination conforming to SSA established procedures in order to evaluate neurological and other indications of incapability. Such requests might be directed to treating physicians or consultants under contract with the agency or otherwise. SSA's requests for medical evaluation of a beneficiary's capability to manage social security benefits, either on its own behalf or through state DDS offices, should be made more specific so as to elicit information useful in determining the beneficiary's need for a representative payee. The VA's procedures might be looked to for guidance. SSA determinations based on such information would not simply adopt the physicians' opinion as to the beneficiary's ability to manage finances. Although information that can be provided by physicians and other health care personnel about a beneficiary's level of functioning is relevant and important to a determination of need for payee assistance, medical professionals are not expert in weighing interests of the beneficiaries in controlling their benefits against the public's interest in ensuring that publicly arranged or provided benefits will be used in the best interest of recipients. Capability determinations made by SSA personnel on this basis would be subject to reconsideration and appeal like the determinations currently made by claims representatives. Such an approach to incapability determinations would not burden beneficiaries and their relatives with cumbersome, time consuming and offensive invasions of privacy which can be entailed in full blown, trial-type adjudications of competence. Cost data related to the implementation of these reforms might be gathered by SSA in a demonstration project in certain social security area offices.

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[177] See generally, A. Shoenberger, "State Disability Services' Procedures for Determining and Redetermining Social Security Claims for the Social Security Administration," 1 Administrative Conference of the United States, *Recommendations and Reports 1987*, 579 (1988).

[178] POMS §GN 00502.050,B,4 (1989). The POMS instructs claims representatives to obtain form 787s from DDS consulting psychiatrists whose DDS evaluations raise capability issues, if no convincing evidence can be obtained from the beneficiary's treating physician.

[179] Interview with Sheila Brown, SSA Branch Manager, Landover, Maryland, December 22, 1989.

[180] See Conference Recommendation 89-10, "Improved Use of Medical Personnel in Social Security Disability Determinations," 1 CFR §305.89-10 (1990). See generally, F. Bloch, "The Use of Medical Personnel in Social Security Disability Determinations," Report prepared for the Administrative Conference of the United States (1989).

# V. Procedures For Determing Need For A Payee

## A. SSA Practice

To understand SSA's determinations of the need for representative payment, it is necessary to understand the procedures that shape them.[181]

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[181] The interrelationship between substantive rights and procedures has often been observed in connection with an analysis of constitutionally guaranteed due process. Due process protects substantive rights, including statutory entitlements, which however, may be created in terms of procedural conditions. See, e.g.,, the opinion of Justice Rehnquist in *Arnett v. Kennedy*, 416 U.S. 134 (1974). Although a majority of the Supreme Court has retained the substantive/procedural distinction for purposes of due process analysis, (see, e.g.,, *Cleveland Board of Education v. Loudermill*, 470 U.S. 532 (1985)) the conceptual dependency of substance on process has been recognized by many commentators. See J. Mashaw, *Due Process and the Administrative State*, 73, 105, 166-67 (1985). In his treatise, Professor Tribe notes that the Court has been willing to look to nonconstitutional sources, such as statutes in the case of public benefit entitlements, to define substantive rights, but constitutional criteria alone to identify the content of the procedural obligations triggered by such rights. Tribe, *American Constitutional Law* 706-707 (1988). So it may be with the right to control the expenditure of one's own social security benefits. The right to control benefits can be regarded as a separate, statutory, substantive right

In general, SSA procedures for determining that a beneficiary is in need of a payee have fallen into three stages which provide serveral redundant and untimely opportunities to contest representative payment. First, the claims representative gathers information relevant to the beneficiary's capability, a process discussed in the previous section. Second, the claims representative makes a determination of incapability and notifies the beneficiary, who may protest and submit additional information. If the claims representative confirms the determination after protest, the decision is implemented, a payee is appointed and paid the beneficiary's benefits, and the beneficiary may seek reconsideration of the determination by someone in the agency other than the claims representative. Third, if dissatisfied with that reconsideration determination, the beneficiary may invoke a de novo hearing (which may be oral) before an administrative law judge (ALJ) and appeal an adverse ALJ determination to the Social Security Appeals Council and the federal courts. The 1990 amendments to the Social Security Act will require SSA to provide notice before implementation. It is not clear whether the amendments may require that the hearing also be provided before implementation.

At each stage, SSA provides fewer procedural safeguards than are provided by state guardianship laws. Because the deprivation of rights resulting from representative payment may be viewed as less significant than that resulting from guardianship, it may be argued that fewer safeguards are merited. In addition, procedures themselves can become burdensome for those they are intended to protect, as when adult children must testify in open court about the incompetencies of their aging parents and proposed wards bear the expense of the proceedings. Nevertheless, the fewer the safeguards protecting rights, the more likely is the imposition of indirect payment in the interest of social beneficence. Yet, as discussed in sections V and VI infra, SSA is not in a position to provide the services necessary to assure that representative payment, in fact, benefits the person entitled to payment.

The due process clause of the Constitution requires only that administrative agencies provide those procedures conducive to accurate applications of law to fact that benefit the interests of the entitled beneficiary more than they burden the government. In the case of representative payment, this has meant few constitutional restraints on agency discretion to balance rights and benefits. Neither do the Social Security Act or the Administrative Procedure Act require the Secretary to use particular procedures to determine when it is in the interest of a beneficiary to be paid through representative payment. The Secretary has

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which sections 205(j) and 1631 of the Act make dependent on the Secretary's not finding the beneficiary "incapable," and this finding depends on the procedures that apply to acceptance and weighting of evidence of incapability.

provided some such procedures in SSA regulations.[182] The agency's procedures and practices are further explained and elaborated in the POMS.[183] However, the POMS is provided only for internal use by agency personnel, and is not regarded by the agency as having the force of law.

## 1. Initiation of Proceedings

SSA has not explicitly addressed the question of who has standing to initiate a determination of the need for a representative payment. The POMS provides that SSA claims representatives are to "develop incapacity," that is, investigate and obtain information regarding mental or physical incapability, when allegations or evidence suggest that the beneficiary may not have the ability to reason properly, is disoriented, has impaired judgment, or is unable to communicate with others.[184] Unlike state guardianship proceedings, there is no requirement that the allegations be made by a person with standing to raise questions about a beneficiary's capability (i.e., a person with an interest in the person's welfare by virtue of a family relationship), custody or financial relationship.[185] The provision is sufficiently broad to permit both a claims representative or a beneficiary to initiate an inquiry into capability on their own motion. This policy seems to be intended to favor assisting vulnerable beneficiaries rather than to protect beneficiaries from unnecessary "capability" proceedings. Since, compared to guardianship proceedings, the appointment of a payee holds less potential for stigmatization or the expense of litigation, a more liberal concept of standing seems appropriate and in keeping with general trends to broaden the concept of standing before administrative agencies.[186]

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[182] 20 CFR §404.2001 et seq; and 20 CFR §§416.601 et seq (1909).

[183] See note 89, *supra*.

[184] This includes allegations of mental retardation, schizophrenia, or chronic brain syndrome. POMS §GN 00502.050, A, 2 (1989).

[185] Statutes generally require that state guardianship proceedings can be initiated only by an "interested person." Forty-five states have such provisions, while the remaining five permit a friend or relative to make application for the appointment of a guardian. S. Brakel, J. Parry and B. Weiner, *The Mentally Disabled and the Law*, Table 7.3 (1985). Persons without an interest in the proposed ward based on family relationship, custody or financial involvement may not set guardianship procedures in motion. In about 30 states, the proposed ward may initiate proceedings for the appointment of a guardian, while in about 12 jurisdictions the state, including the court itself, may move for such an appointment. *Id.* In states without explicit provisions governing standing to initiate guardianship proceedings, courts must struggle with the tension between policies favoring the protection of people in need of assistance and those against the unnecessary imposition of stigma and inconvenience involved in opposing the appointment of a guardian. 20 CFR §404.2030(a) (1988) ("we notify the beneficiary or the individual acting on his or her behalf of our proposed actions . . . that we plan to name a representative payee and who that payee will be"); 20 CFR §416.630 (1988); POMS §GN 00502.310A (1989).

## 2. Notice

It is SSA's practice to provide beneficiaries notice of its incapability determinations only *after* they had been made, and provide dissatisfied beneficiaries a hearing only after payment to the payee has begun. The 1990 amendments do not require SSA to change these practices. The Act as amended requires the Secretary to provide notice to the beneficiary before certification of payment to a payee which it currently does through "advance notice."[187] OBRA does not require either notice or hearing prior to the Secretary's determination that the beneficiary is incapable of handling benefits.

SSA's current regulations require that "advance notice" be sent to initiating parties and beneficiaries of SSA's "proposed action" to appoint a payee.[188] However, the POMS provides that the notice is to be sent only after incapability has been established and a proposed representative payee has been chosen.[189] It should be noted that while the agency does not regard its first determination that a payee is needed as an initial determination to which notice and appeal rights attach, it is in practice this determination that the beneficiary must reverse to prevent the appointment of a payee. Furthermore, the notice does not inform the beneficiary of the standard SSA will use to determine whether he or she is capable of managing benefits. The indeterminacy of the "capability standard" makes it especially difficult for a beneficiary to know what evidence the agency might find relevant and hence what evidence he or she might submit to dispute the conclusion already reached.[190] Advance notice is sent to the beneficiary and each person being considered as representative payee.[191]

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[186] See generally, Stewart and Sunstein, "Public Programs and Private Rights," 95 HARV. L. REV._ 1193 (1982). Like SSA determinations, the VA proceedings are initiated when information is received that a VA beneficiary may be in need of assistance which can be provided within the scope of the VA fiduciary program or is incapable of handling his or her funds. Again, there are apparently no requirements that the person bringing information to the VA's attention have any particular relationship with or interest in the welfare of the beneficiary.

[187] 42 U.S.C.A §405(j)(2)(E)(i) and (ii) and §1383(a)(2)(B)(x) and (XI). While notice must be given in advance of certified payament, a hearing is to be provided as in the case of entitlement determinations, which have been held to permit post determination and postimplementation hearings. See e.g., *Mathews v. Eldridge*, 424 U.S. 319 (1976).

[188] 20 CFR §404.2030(a) (1990) ("we notify the beneficiary or the individual acting on his or her behalf of our proposed actions . . . that we plan to name a representative payee and who that payee will be"); 20 CFR §416.630 (1990); POMS §GN 00502.310A (1989).

[189] POMS §GN 00502.310, B, 2 (1989) provides "[t]he notice may be sent only after incapability has been established and a proposed RP has been chosen."

The notice informs the beneficiary that a decision to appoint a payee has been made, that the beneficiary has an opportunity to review the evidence upon which the decision was based and to submit additional evidence before the decision is implemented. It does not provide a statement of the reasons why the decision was made except to state that "the facts we have showed that this would be best for you."[192]

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[190] In his book, *Due Process and the Administrative State*, Professor Mashaw describes the befuddlement of participants in some administrative proceedings which lack clear standards, predictability and rationality as follows:

> They know only that they seem to be involved in an important decision concerning their lives. But they have no idea what is relevant to the decision, who will make it, and in the extreme case, what precisely the decision is about. Perhaps the only thing that becomes clear in such a process is that if and when a decision is made, the participants will not be given any understandable reasons for it. J. Mashaw, *Due Process and the Administrative State* 175 (1985).

[191] In addition, unless they have consented to the appointment of a payee, the parents or legal guardian of a minor beneficiary are also notified. When the beneficiary is a legally incompetent adult, the legal guardian is sent the notice unless he or she has consented to the appointment. POMS §GN 00502.320 A, 3 (1989). No advance notice will be sent to a legally competent adult who has been determined by SSA to be incapable of handling benefits, if he or she has consented in writing to the appointment of a payee. POMS §GN 00502.330 (1989).

[192] SSA's notice states:

> "We are writing to let you know that we plan to make ____________________ your representative payee. This means that ________________would get your Social Security checks each month and would use this money for your needs. The facts we have show that this would be best for you.
>
> If you think that you should get your own checks or that we should choose someone else besides ____________________to get your checks for you, you should let us know right away. You have 10 days from the date of this letter to do this. When you contact us you can:
>
> Ask us to explain more about our plans.
>
> Ask to see the facts in your file.

The determination that triggers the advance notice is not regarded by the agency as an "initial determination" (to which protest procedures and appeal rights attach), but a preliminary action permitting the beneficiary to provide additional information to the agency before its decision is implemented.[193] If a beneficiary lodges a valid protest with SSA within 10 days of the receipt of advance notice of the incapability determination, the determination will not be implemented.[194]

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> Give us more facts to consider before we make our final decision.
>
> You can tell us if you agree or disagree by filling out the last page of this letter."

Sample Notice of Planned Action, used by the Social Security Administration Office, Landover Mall, South Building, Landover, MD 20785, December 15, 1990.

Notice to someone other than the beneficiary of the selection of a particular payee is given by the following notice:

> We are writing to let you know that we plan to make ____________ the representative payee for _______. This means that ____would get social security checks each month and use this money for ______needs. The facts we have show that this would be best for ____.If you think that we should pay _____ checks to someone else, you should let us know right away. You have 10 days from the date of this letter to do this.
>
> If we do not hear from you in the next 10 days, we will send checks to _____. If you have any question, you should call, write or visit any Social Security office....*Id.*

[193] Advance notice is ordinarily required when a representative payee is being appointed at the same time benefits are initiated, when representative payment is initiated after a period of direct payment of benefits to the beneficiary, when payment to a representative payee is being resumed after an interruption and when payments to a child beneficiary will continue to a payee after the child reaches the age of 18. POMS §GN 00505.310 B, 1 (1989).

[194] POMS §GN 00502.440 (1989). A protest may also be made by telephone but must be followed by a written protest within 10 days to be effective. POMS §GN 00502.400, A, 3 (1989). Certain exceptions to these rules are made where the agency determines that sending the advance notice would serve no useful purpose. Thus, advance notice is not sent to minor children, adult beneficiaries adjudicated legally incompetent or the legal guardian of an adult beneficiary when the guardian is the proposed payee. POMS §GN 00502.320, A, 3 (1989). As observed in the previous section, because some state guardianship laws serve purposes different from SSA's, adult beneficiaries determined to be legally incompetent may have an interest in

The practice of sending "advance notice" after a determination of incapability has been made is arguably inconsistent with the procedures set forth in SSA regulations, which provide that the beneficiary will be given advance notice of "proposed action." While proposed action could mean either the determination of incapability or payment to a representative, the regulations leave the impression that notice will be given prior to any determinative action by the agency. The determination that a beneficiary is in need of a payee is the decisive one. Once that determination is made, payment to a representative is required.

Almost all state guardianship laws expressly provide that proposed wards shall be given notice before an action affecting their rights is taken.[195] However, state law varies as to who must be served with the notice and how they must be served.[196] Statutes or the courts require that notice of the proceedings be sent to the proposed ward within a "reasonable" amount of time before the proceeding, usually from 3 to 15 days. The major difference between the notice requirements of most states and that of SSA is that under state laws, notice must be sent in every case before both an incompetency determination and action to protect the property of the ward. Under SSA's POMS, notice is not given before an incapability determination but only before action is taken to make payment to the payee.

Unlike SSA, VA notifies beneficiaries that the field office has undertaken an investigation of competence and permits the beneficiary to submit relevant evidence before a competency determination is made. Since all VA investigations of competence require a face-to-face interview between the field examiner, the beneficiary and the proposed fiduciary, the beneficiary has an opportunity to submit oral evidence. Notice of this opportunity is sent before the field examiner requests either an incompetency rating by the Rating Board or an adjudication of incompetence by a state court.

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being notified of a pending SSA incapability determination so that they may present evidence indicating their capability to handle their SSA benefits.

[195] Only three states, Alabama, Louisiana and Mississippi, fail to expressly require notice to the proposed ward.

[196] Forty-eight states require that the proposed ward be directly informed of the place, time and kind of proceeding that has been scheduled. Many states also require that the person's nearest relative or custodian also be notified. If the notice is written in such a way that it cannot be understood by the proposed ward or representative and the ward does not attend the hearing, the notice will be regarded as defective and the appointment of a guardian may be void or voidable. Although all states require written notice, some notices have been challenged on the grounds that they were so technical that the reasonable average person would have difficulty determining their import. S. Brakel, J. Parry and B. Weiner, *The Mentally Disabled and the Law*, Table 7.3 (1985)

## 3. Hearings

While SSA does not call the fact-finding procedures used by a claims representative a hearing, the procedures can be regarded as a hearing in a broad sense. That is, the procedures permit interested parties to present evidence to a decisionmaker who will make findings of fact and legal conclusions binding on the parties unless successfully appealed. Several courts have made it clear that for constitutional due process purposes, something less than a full-blown testimonial hearing is appropriate and constitutionally adequate for many purposes.[197] Interestingly, while neither the statute nor SSA regulations require notice and a face-to-face interview with the beneficiary proposed for representative payment, the Social Security Act as amended in 1990 requires SSA to conduct a face-to-face interview with each payee applicant where practicable.[198]

### a. Protest

SSA guidelines provide that when a valid protest is made, a claims representative must review all of the factors leading to the determination and any new evidence submitted by the beneficiary. A valid protest must be filed in writing within the time allotted (usually 10 days), and indicate the reasons why the beneficiary believes direct payment should be made. The legally competent beneficiary, the guardian of a legally incompetent beneficiary or a legal representative, have a right to review the application for a representative payee and related material in the file. Other persons may also review the evidence if the manager of the field office determines that it is appropriate.[199]

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[197] See discussion at notes 257-264.

[198] OBRA 1990 to be codified at 42 U.S.C. §§405(j)(2)(A)(i) and 1383(a)(2)(B)(i)(I).

[199] POMS §00502.400, A, 4 (1989). However, the guidelines provide that when a competent adult beneficiary asks to review evidence, and there is reason to believe disclosure would pose a serious hazard to the beneficiary or some other person who provided information, the beneficiary will be requested to designate a representative to review the evidence. If the beneficiary objects, the Office of Disability will make a determination on disclosure.

The POMS does not indicate what kind of hazards are to be regarded as serious for these purposes. It is not hard to imagine many instances in which it would be embarrassing and uncomfortable for relatives and neighbors who have made allegations of incapability to have their allegations made known to the beneficiary. However, fundamental fairness would seem to require that unless there is a real likelihood of serious mental or physical harm resulting from disclosure, all information upon which an incapability determination is based should be available to a protesting beneficiary. For this reason, it has been the agency's policy in the past, to order direct payment where a competent adult beneficiary objected to the appointment of a representative payee and was denied the opportunity to review sensitive evidence supporting the appointment. Social Security Law and Practice, §32:19 (1986).

While the beneficiary may submit written evidence to the claims representative, it is unclear to what extent the beneficiary has a right under agency regulations to submit his or her own oral testimony or that of other witnesses. Oral conversations between the claims representative and others are routinely recorded on a "contact" report form which is included in the file and thus constitutes part of the record reviewed upon protest and reconsideration.

After the beneficiary's review of the agency's evidence and the submission of additional evidence, if any, the agency will either confirm or abandon its decision. If the claims representative decides that the proposed decision should be implemented despite the protest, a second review must be made by a different claims representative.[200] POMS further provides that at this stage a decision to appoint a payee should be reversed if protested by a legally competent adult unless there is convincing evidence clearly establishing that the beneficiary is not able to handle his or her benefits.

Available data show that few protests of capability determinations are lodged and about half are successful. Although little information about representative payee determinations is kept by SSA, an SSA study of all initial and post-entitlement representative payee determinations between January 1977 and June 1979 disclosed that of 52,000 representative payee determinations on initial claims, less than 2 percent of the beneficiaries protested the proposed determination.[201] About half of this 2 percent were sustained. Of the 287,000 post-entitlement representative payee determinations, 4.4 percent were protested and more than half of the protestants were successful.[202] These figures understate the percentage of cases involving competent adults because they pertain to all payee determinations, including those in which parents are appointed for minor children, (about two-thirds of the payees appointed), where there is rarely a dispute about the propriety of the appointment. The percentage of competent adults who object to the appointment of payees is thus significantly higher.

Until implementation of the 1990 amendments, SSA will maintain its curent practice with regard to notice and hearing. Thus, currently, if the incapability determination is confirmed, it is regarded by the agency as an "initial determination" and will be implemented immediately[203]--payment to a representative payee will begin. At the same time, the agency will issue a written "formal notice" to the beneficiary, all parties with rights of appeal and other persons affected by the determination.[204] Those who have a right to appeal certification include the legal guardian of a legally incompetent adult beneficiary and the legal guardian, natural or adoptive parents or custodian of a minor beneficiary, unless they are otherwise disqualified. If the beneficiary is a legally incompetent adult, the determination of the need for a payee is not considered an initial determination and, thus, neither the beneficiary nor his or her guardian has a right to appeal.[205] The selection of a particular payee is also appealable by the beneficiary and therefore subject to advance and formal notice requirements.[206] Thus, the formal notice is sent to the beneficiary, the appointed representative payee, unsuccessful payee applicants and the attorney or legal representative of the beneficiary such as a guardian or conservator.[207]

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[200] POMS §GN 00502.400, A, 1 (1989).

[201] Jordan v. Schweiker, Civ-79-994-W, 7-8 (W.D. Ok. March 17, 1983). Order of Judge West on Plaintiff's Motion for Summary Judgement and Defendant's Cross Motion For Summary Judgment.

[202] *Id.*

[203] POMS §GN 00502.400 B, 2 (1989). A determination of the need for and selection of a representative payee for a person entitled to benefits under Title II is considered an initial determination subject to reconsideration and appeal procedures. 20 CFR §404.902(o) (1987). A

The notice informs the addressee of the action taken by the agency and the way in which the addressee may pursue an appeal of the action within the agency. A beneficiary or applicant payee who disagrees with the initial determination of the agency may seek a reconsideration. When effective, the 1990 amendments will require SSA to provide written notice of the initial determination "in advance of certification" (i.e., before implementation). In addition, SSA must provide hearings "to the same extent as is provided in subsection (b) of section 205 (b)." SSA has not yet issued implementing regulations. Since section 205 (b) requires the beneficiary be sent a notice containing a "statement of the case," a discussion of the evidence, and the reasons upon which the determination is based, SSA will have to revise its current practices and provide more informative formal notice of initial determinations.[208]

### b. Reconsideration

Unlike the VA procedures, reconsideration of an initial determination by SSA to appoint a payee is provided after both an incapability determination and implementation of the decision. It is provided in accordance with the

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determination that an SSI beneficiary is not capable of handling his or her benefits and the selection of a representative payee are also initial determinations subject to reconsideration and appeal. 20 CFR §416.1402(d) (1990).

[204] POMS §GN 00502.600 and .610 (1989).

[205] POMS §GN 00502.003 B1, 2 and 3, a (1989).

[206] 20 CFR §§404.905(n), 404.902(p) (1990);POMS §GN 005 2.003,A,2 (1989).

[207] POMS §GN 00502.600 B, 2 (1989). However, a determination not to appoint a payee applicant is not appealable by the proposed payee. POMS §GN 00502.003 B, 3, e (1989).

[208] 42 U.S.C. §405(b)(1988).

general rules governing appeals from other kinds of social security determinations, such as disability determinations.[209] In keeping with its policy of *not* providing the services of a payee merely upon request, the determination not to make payment to a representative payee is not considered an initial determination and thus no right to reconsideration or appeal (administrative or judicial) is provided.[210] To the extent that unappealable erroneous determinations result in the retention of benefit control by incapable beneficiaries (false negative determinations) this policy places the risk of error on the government's interests in beneficence rather than individual autonomy interests. The determination to pay a representative, which itself confirms the earlier decision that a payee is needed, is considered an initial determination, for which reconsideration may be sought.[211]

Reconsideration consists of a review of the written file and basis for the original decision by a new claims representative.[212] New evidence may be, but seldom is, submitted at this stage, and it is unusual for a beneficiary to appear in person to submit information upon a reconsideration review. It is difficult to see the utility of this additional layer of paper review prior to de novo review by an ALJ. Although few statistics exist on reconsideration of payee decisions, statistics for disability determinations in 1986 show that of the 380,000 reconsideration decisions issued, only 17 percent were favorable to the objecting beneficiary, while data indicate that about 50 percent of reconsideration determinations heard de novo by ALJs are overturned.[213]

### c. ALJ Review

When it becomes effective in October 1992, the OBRA amendments will provide any individual dissatisfied with a determination to certify payment is entitled to a hearing "to the same extent provided" to persons contesting eligibility determinations.[214] As noted, SSA notice, hearings and appeals procedures are already patterned on those afforded in entitlement controveries, as described below.

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[209] 20 CFR §404.203(b); 20 CFR §§404.907-22 and 416.1407-22 (1986). Prior to its 1989 revision, the POMS indicated that determinations to continue payments to a payee when the beneficiary has requested resumption of direct payment, determinations to suspend benefits and determinations not to pay accrued benefits in a lump sum were also initial determinations subject to reconsideration and appeal. POMS §GN 00502.010 (1989). See generally, F. Bloch, Report and Recommendations on the Social Security Administration's Administrative Appeals Process, Conference (July 1989).

[210] See 20 CFR §404.903(c) (1990) in connection with Title II benefits and 20 CFR §404.416.1403(c) (1990) in connection with Title XVI benefits.

[211] *Id.*

[212] Occasionally, a supervisor of one of the claims representatives involved in earlier decisions will participate in the reconsideration review. Interview with Sheila Brown, Branch Manager, Social Security Field Office, Landover, Maryland, December 15, 1989.

[213] Koch and Koplow, ACUS Recommendations and Reports (1987) at p. 667.

Although the 1990 Act clearly requires preimplementation notice, it does not require a preimplementation hearing. Furthermore, as discussed in section V, C. herein, due process has not been held to require one in most contexts. Thus, the reconsideration provided before implementation together with a post-implementation ALJ hearing may well satisfy both constitutional and statutory hearing requirements, unless due process is held to protect the interest in not being determined incapable apart from the interest in retaining control over benefits.

At present a beneficiary who is dissatisfied after reconsideration of the appointment of a representative payee, may appeal the determination within 60 days to an ALJ within the agency.[215] Beneficiaries have a right to be represented before an ALJ by a lawyer or lay advocate. The SSA does not provide counsel to those who cannot afford it but must approve fees paid by claimants for representation.[216] There is little data indicating how often beneficiaries are represented in these proceedings. In the case of disability determinations, it has been determined that 65 percent of claimants have legal representation before the ALJ and 18 percent have nonattorney representation.[217] Since, unlike disability determinations, successful objections to payee determinations may result in no award out of which lawyers can be paid, it is likely that fewer beneficiaries protesting payee determinations find representation. This may account for the relatively small number of requests for reconsideration of incapability determinations.

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[214] OBRA §1505(a)(2)(A)(i) and (ii) to be codified as 42 U.S.C. §405(j)(2)(E)(i) and 1383(a)(2)(B)(x).

[215] 42 U.S.C. §§405(b)(1), 1383(c)(1) (1988); 20 CFR §§404.929-65, 416.1429-1465 (1986). There are about 700 ALJs conducting SSA hearings in 132 offices around the country. Koch and Koplow, "The Fourth Bite at the Apple: A Study of the Operation and Utility of the Social Security Administration's Appeals Council," Report for Recommendation 87-7, Administrative Conference of the United States, Recommendations and Report (1987) at 625-831 (1988).

ALJs are paid at the GS 15 level and may be removed only for good cause, to ensure their decisional independence and objectivity. APA standards and procedural requirements are not required by statute to be applied in SSA proceedings, but have been incorporated into most SSA practices. Koch and Koplow, supra at 125-126. D. Cofer, Judges, Bureaucrats, and the Question of Independence: A Study of the Social Security Administrative Hearing Process 66-70 (1985)

[216] Cofer, supra note 215 at 11. and see generally Hostetler, "Nonlawyer Assistance to Individuals in Federal Mass Justice Agencies: The Need for Improved Guidelines," 2 ADMIN. L. J. 85 (1988).

[217] Social Security Forum No. 3, 7 (March 1987). Most such representatives are paid SSA approved fees, 25 percent of which can be withheld by SSA from the beneficiaries' entitled benefits. Because in cases involving the appointment of a payee, no entitlement to benefits is at issue out of which an attorney could be paid, it may be that there is less likelihood that an attorney or lay advocate will assist at the ALJ and Appeals Council stage in these cases.

The ALJ appeal provides the objecting beneficiary with a hearing de novo.[218] That is, the ALJ is not bound by the claims representative's determinations, even if they are not arbitrary and are supported by substantial evidence. Rather, the ALJ reviews the written record, accepts additional evidence, written or oral, and makes a new determination of the issue. Oral testimony is given under oath, though written evidence need not be verified. The rules of evidence are not applied, and the ALJ acts as both inquirer, questioning witnesses to elicit information, and adjudicator. Usually the proceedings, which may last about an hour, are taperecorded to provide a record for appeal.

Little information is gathered by SSA about hearings held on representative payee issues.[219] Unlike the case of disability determinations, recent statistics are unavailable concerning how many representative payee determinations are protested, how many are successful, how many are granted reconsideration, how many of those are successful, how many are appealed to ALJs, how many of those are reversed and how many are appealed to the Appeals Council.[220] The prevailing opinion of persons in the agency is that very few determinations of the need for a payee are protested, appealed or reversed by the agency.[221] This may reflect a general satisfaction with the results of SSA determinations, which provide an informal, relatively speedy mechanism for resolving sensitive personal issues before a decisionmaker reflecting common sense and community values. It may also reflect the fact that most payee cases involve children beneficiaries where parents are chosen as payees with little controversy. On the other hand, at least with regard to adults who have not been adjudicated incompetent, most are elderly, unrepresented, and many are infirm and vulnerable. This, too, may contribute to the low rate of protests.

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[218] See generally, J. Mashaw, C. Goetz, F. Goodman, W. Schwartz, P. Verkuil & M. Carrow, *Social Security Hearings and Appeals* (1978).

[219] For data about hearings regarding entitlement to disability payments see Koch and Kaplow, supra note 218 at 672, fn. 131.

[220] Interview with Fred Graf, SSA Payment Specialist, December 15, 1989. For the results of one SSA study of representative payee determinations see the discussion at notes 204 and 205, infra. For data concerning the number of disability determinations appealed successfully at various levels of review see J. Mashaw, *Bureaucratic Justice: Managing Social Security Disability Claims* 22, 41-42 (1983) and D. Cofer, Judges, *Bureaucrats, and the Question of Independence: A Study of the Social Security Administrative Hearing Process* 108 (1985).

[221] Interviews with Fred Graf, SSA Payment Specialist, November 19, 1989 and William Taylor, Executive Director, SSA Appeals Council, December 14, 1989.

## 4. Appeals Process--The SSA Appeals Council Review

Although very few payee disputes seem to be appealed beyond the ALJ stage, a disappointed beneficiary may appeal an adverse ALJ determination of incapability or the selection of a payee to the SSA Appeals Council. The SSA Appeals Council is a 20-member body created by SSA regulation[222] which reviews certain agency determinations.[223] The Council's review is discretionary; it screens requests for review and grants full consideration to only a portion.[224] The Council has established various criteria for accepting disability cases, but it is not known what criteria are used in representative payee cases.[225] In general, the Council grants review in cases where it determines that the ALJ's decision and order were not correct or needs modification, or about 25 percent of the cases in which review is sought.[226] When review is granted, the beneficiary is entitled to a copy of the written record and the tape recording of the ALJ hearing and again is entitled to be represented by lay or professional counsel. There is some question whether the beneficiary may submit new evidence at this stage of the appeal process.[227] Evidence pertaining to events occurring since the ALJ's decision is likely to be rejected by the Council on the theory that it may be relevant to a new claim but not the one adjudicated by the ALJ.[228]

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[222] 20 CFR §§404.967-83 and 416.1467-83, 422.205 (1990).

[223] 20 CFR §§404.970; 416.1470 (1990).

[224] Koch and Kaplow, supra note 215 at 706.

[225] Interview with William Taylor, Executive Director, SSA Appeals Council, December 14, 1989.

[226] Koch and Kaplow, supra note 215 at 714. For instance, in 1986, of the 44,621 cases disposed of by the Council, the great majority of which involved disability determinations, it denied review in 65 percent, dismissed 12 percent and accepted review in 23 percent. Of the cases accepted for review, the Council reversed the ALJ in 23 percent, remanded 65 percent and affirmed 12 percent OHA Operational Report at 27 (September 30, 1986), cited in Koch and Koplow, supra note 215 at 714, 717. However, the 1986 reversal and remand rate was much higher than previous years due to statutory intervention requiring remands for large numbers of mental impairment cases. In previous years the remand rate was closer to 8 percent and the reversal rate 5 percent. *Id.* at 717, n. 248.

[227] 20 CFR §§404.976, 416.1476 (1986). Koch and Koplow, supra note 215 at 719.

[228] Like other SSA decisionmakers, the Council copes with an enormous caseload. It is estimated that each member is assigned about 500 cases a month and typically spends about 10 to 15 minutes per case, reviewing the record and making a decision. Koch and Koplow, supra note 215 at 732. The average length of time necessary to process an appeal from the filing to decision was between 3 and 4 months in 1986. Since most of these cases involve complex determinations about medical conditions and ability to gain employment, circumstances usually not at issue in cases involving payees, it is likely that even less time would be devoted to such cases at the Council level.

Council decisions are not considered precedential.[229] The lack of precedential effect means that Council decisions cannot fill the gap left by the statute and SSA regulations with regard to the standard to be applied to determine the need for a payee. A decision of the Council constitutes a final determination by the agency, permitting the beneficiary to seek judicial review in federal district court where he or she resides.[230] Where the beneficiary raises constitutional objections, the requirement of exhaustion of administrative remedies is waived, and the appeal may be brought directly to court, without an appeal to the Council.[231]

The ability of federal courts to authoritatively determine the legal requirements obtaining in SSA cases, generally, is at issue in the agency's "nonacquiescence policy."[232] SSA's current policy seems to be to acquiesce in most cases involving interpretation of the Social Security Act and agency regulations. If this policy is continued, it would permit the federal courts to play a part in the formation of policy and procedures bounding the representative payee program.

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[229] The Office of Hearings and Appeals also publishes an *OHA Law Reporter*, which contains some ALJ and Council decisions but makes it clear that decisions published in the *Reporter* are not to be considered as authority which can be cited. Preface page, *OHA Law Reporter* (1989). The *Reporter* also publishes selected federal court cases, SSA Rulings (which are regarded by the agency as binding on agency decisionmakers), Federal Register material and Appeals Council Minutes.

[230] 42 U.S.C. §§405(g) and (h) (1988).

[231] Moore v. East Cleveland, 432 U.S. 494 (1977); Schwartz, *Administrative Law*, §8.37 (1984). Briggs v. Sullivan, CV-89-0203 EJC (September 25, 1989) (the court found that plaintiffs had presented their claims to the Secretary and that the Secretary's action in suspending benefits where no payee could be found would cause irreparable injury and administrative appeal would be futile, constituted a waiver of the requirement that administrative procedures be exhausted and provided the jurisdictional predicate for judicial review in compliance with the conditions of 42 U.S.C. §405(g)).

[232] In general, the federal district courts are bound to follow as precedent the decisions of the court of appeals for the geographic circuit of which they are a part, but not the decisions of other circuits. Thus, the federal courts are free to decide the same statutory or constitutional issue in different ways, the Supreme Court being the final arbiter. Federal agencies have long taken advantage of this judicial system to seek favorable rulings in different circuit courts and appeal adverse decisions to the Supreme Court, as a means of developing uniform national policy. Nonacquiescence is the selective refusal of an administrative agency to conform its actions to the rulings of courts of appeals until the ruling has been passed upon by the Supreme Court. Estreicher and Revesz, "Nonacquiescence by Federal Administrative Agencies," 98 YALE L. J. 679, 681 (1989). As applied before 1985, SSA's nonacquiescence policy provided that SSA would implement an adverse decision of a federal court only in the case that precipitated the order, but would not apply it prospectively to other cases even in the same federal circuit, and would issue a ruling to that effect. *Id.* 692-699; see generally, Koch and Koplow, "The Fourth Bite at the Apple: A Study of the Operation and Utility of the Social Security Administration's Appeals Council," 17 FLA. STATE L. REV. 199, This policy has been criticized by many commentators and members of Congress as unnecessary to the development of uniform national policy since the agency could seek Supreme Court review of statutory and constitutional decisions with which it disagreed. Estreicher and Revesz, supra at 681, fn.8. Further, it has been viewed

## 5. Redeterminations of Capability

Consistent with its limited resources and passive posture with regard to providing representative payee services, redeterminations of capability are left to beneficiary initiative. SSA regulations provide that a beneficiary who is in representative payment may petition to be paid directly. It is not clear whether others, such as the payee, may petition in the beneficiary's behalf.[233] The beneficiary bears the burden of proving capability in such situations and must demonstrate to SSA that he or she is mentally and physically able to manage or direct the management of benefit payments.[234] The same evidentiary rules establishing conclusive presumptions of incapability would seem to apply.[235] To demonstrate capability, the beneficiary may submit a physician's statement showing that in the physician's opinion the beneficiary is able to manage his or her funds, a copy of a court order restoring the rights of a beneficiary adjudicated legally incompetent, or other evidence of capability.[236] Title XVI beneficiaries whose representative payment was based on a finding of drug addiction or alcoholism must prove that the determination of addiction "is no longer applicable." Interestingly, beneficiaries originally determined incapable on the basis of medical evidence may reestablish capability on the basis of lay

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as hard on beneficiaries who were thus required to relitigate the same issues over and over even in the same circuit. H. R. Rep. No. 618, 98th Cong. 2d Sess. reprinted in U.S. Code Cong. & Admin. News 3061 (1984); Lauter, "Disability-Benefit Cases Flood Courts," 6 NATIONAL LAW J. No. 6 1 (Oct. 17, 1983) and Kubitschek, "Social Security Administration Nonacquiescence: The Need for Legislative Curbs on Agency Discretion," 50 U of PITTSBURGH L. REV. 399 (1989).

In 1985, SSA changed its policy. Reserving the right to appeal circuit court decisions and to relitigate the same issue in other circuits, the agency now publishes the cases in which the agency will "acquiesce" in future cases brought in that circuit. Interim Circular No. 185 for inclusion in OHA Handbook, June 3, 1985: Proposed regulation, 52 Fed. Reg. 5, 2557 (Jan. 23, 1987). While the listing of cases indicates when the agency will acquiesce, it leaves unpublished the list of cases in which the agency will not acquiescence. For a fuller description of SSA's nonacquiescence policy and its subsequent history see Estreicher and Revesz, supra 694 - 704.¨[Final rule issued January 11, 1990.]

[233] Most guardianship laws permit petitions for restoration to be initiated by such "other interested persons". Brakel, Parry and Weiner, *The Mentally Disabled and the Law*, 393 (3rd ed. 1985).

[234] POMS §GN 00502.050 (1989).

[235] POMS §GN 00502.220, B (1989).

[236] *Id.*

evidence alone. Only where lay evidence is not convincing are claims representatives instructed to obtain medical evidence.[237]

SSA does not require automatic redetermination of capability, except where a representative payee cannot be found.[238] Again, the agency depends on the initiative of the beneficiary or other parties to bring changed circumstances to its attention. It does not solicit such information, either through questionnaires to beneficiaries or through personal contacts. It might be that establishing procedures for the automatic reassessment of capability, at least in those circumstances in which capability is likely to have been restored, would result in fewer beneficiaries under representative payment and thus fewer monitoring and enforcement responsibilities for the agency.

## B. State Guardianship And VA Procedures

State guardianship proceedings provide the proposed ward or beneficiary greater hearing rights and similar appeals rights compared to those provided by SSA. State guardianship laws generally allocate jurisdiction over guardianship and conservatorship matters to probate courts, and provide for judicial review in intermediate courts of appeal and the state supreme court. Like federal court review of SSA determinations, these state appellate courts decide questions of law and review findings of fact to determine if they are supported by substantial evidence. Almost all states presume a legally incompetent person remains so until the ward or an interested person petitions for restoration of rights. California provides for automatic restoration of rights unless conservators apply for reappointment and some states require automatic periodic review of guardianships.[239]

The VA system provides beneficiaries both notice and an opportunity to be heard before a determination is made that they are not capable of managing their benefits. The VA system differs from SSA in that, unlike the claims representative, the field examiner is not the decisionmaker with regard to the beneficiary's capability. VA personnel are instructed only to gather information[240] and to determine whether the facts show that there may be a need for VA services, including the establishment of alternative payment methods, to protect the beneficiary's interests.[241] In addition, VA personnel are instructed to make personal visits to the beneficiary or field examinations to develop necessary information. The VA will make representative payment only if the beneficiary is adjudicated incompetent either by the VA's Adjudication Division or Rating Board or by a state court.[242]

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[237] POMS §GN 00502.220, A, 4 (1989).

[238] POMS §§GN 00502.210 and 00502.180 (1989). The latter section requires a follow-up contact with beneficiaries in direct payment because a representative payee cannot be found.

[239] Brake, Parry and Weiner, *The Mentally Disabled and the Law*, 393, tables 7.4 and 7.6 (3rd ed. 1985).

[240] If on the basis of such information, field office personnel find that a determination of competency should be made, the field office notifies the Veterans Service Division (VSD). Most VA field offices or stations contain a fiduciary and field examination unit within the VSD. The

If the beneficiary being investigated is under a legal guardianship, the field office may either appoint the guardian as the VA fiduciary or select someone else. Although the supremacy clause of the Constitution permits the VA to appoint a fiduciary other than the guardian to handle VA benefits,[243] most often, the field examiner will certify the guardian as the VA fiduciary. The VA estate analyst will require accountings from such fiduciary-guardian as part of, or in addition to, accountings to the state court.[244] If the beneficiary is not under legal guardianship and the field examiner determines that the appointment of a fiduciary should be made, and the examiner must seek either a VA rating of incompetence from the Adjudication Division, or seek a state-appointed guardian through VA legal counsel.[245]

VA field examiners are instructed to inform the Veterans Services Division (VSD) in the state that the agency seeks appointment of a fiduciary and the VSD will then determine whether a "rating action" is necessary. A "rating action" is a determination by a VA Rating Board, part of the Adjudication Division, as to whether a beneficiary is competent. The Adjudication Division may request VSD to order a field examination if one has not been conducted. If, after consideration of the information before it, including the field examiner's report of its field examination and the reports of examining physicians, the Rating Board determines that the beneficiary is incompetent, it may request the VSD to certify or recertify a fiduciary. In such cases, the VSD will either appoint a fiduciary, recommend direct payment, or recommend supervised direct payment.[246] In sum, afater notice and an

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unit is primarily responsible for the administration of the fiduciary program at the client level. Letter of Thomas K. Turnage, Administrator, The Veterans Administration, to Honorable Don Bonker, Chairman, Subcommittee on Housing and Consumer Interests, House of Representatives, Washington, DC, October 8, 1988.

[241] Veterans Administration, Veterans Services Division Operations, Field Section, Department of Veterans Benefits Manual, §2.05 (1975 as amended October 23, 1981), (VSD Manual).

[242] 38 CFR §13.55 13.58 and 13.59 (1990).

[243] 38 CFR §13.58 (1990).

[244] 38 CFR §13.59 (1987). Interview with William Saliski (September 21, 1989).

[245] VSD Manual, §2.05a (1975 as amended 1981).

[246] VSD Manual, §2.05b (1975 as amended 1981).

opportunity for a hearing before the Rating Board or a state court, the VSD is authorized to make direct payment to a beneficiary rated incompetent, make direct payment of part of such benefits to the beneficiary, or order payment supervised by the Veterans Services Officer, unless the veteran is under a legal disability.[247]

## C. Constitutional Requirements

### 1. The Protected Interests--Capability and Control Over Entitlements

Whether the SSA procedures described above conform with constitutional due process requirements depends as a threshold matter upon whether a beneficiary's interest in controlling the expenditure of social security benefits is a constitutionally protected liberty or property interest.[248] The Supreme Court has held that in order to be protected by due process, an interest must be defined by constitutional provisions or specific state or federal rules of law--statutory or common law.[249] Nevertheless, this positivistic approach has not prevented the Court from recognizing as property interests legal rights that do not constitute full legal ownership,[250] or from recognizing as protected liberty, a person's interest in a good reputation, so long as damage to it affects a legal right, such as the right to contract or purchase goods.[251] A social security beneficiary can be said to have a personal interest in not being determined "incapable" which is akin to one's liberty interest in a good reputation or property interest in controlling the disposition of belongings. This interest, coupled with the determination's impairment of the legal right the beneficiary would otherwise have to expend his or her benefits, should support a finding that the interest of beneficiaries (apart from entitlement) in controlling the expenditure of social security benefits is an interest entitled to due process protection. Federal courts entertaining due process challenges to the procedures used in the representative payee program have reached the same conclusion, though usually without detailed analysis.[252] As discussed below, whether beneficiaries have a constitutionally cognizable interest simply in the unimplemented determination that they are "incapable" of managing social security benefits is more problematic.

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[247] 38 CFR §13.56 (1987).

[248] The Constitution does not require that due process be provided whenever personal interests are affected by government action. *O'Bannon v. Town Court Nursing Center*, 447 U.S. 773 (1980). Rather it requires such process only where certain property or liberty interests found by the Supreme Court to be constitutionally protected are involved. *Board of Regents v. Roth*, 408 U.S. 564 (1972). See generally, VanAlstyne, "Cracks In The New Property: Adjudicative Due Process in the Administrative State, 62 CORNELL L. REV. 445 (1977); Rubin, "Due Process and the Administrative State," 72 CAL. L. REV. 1044 (1984); Simon "Liberty and Property in the Supreme Court: A Defense of Roth and Perry," 71 CAL. L. REV. 146 (1983).Interests regarded as "mere expectations" are not protected and may be affected by state action arbitrarily and without a hearing. See, e.g.,, *Leis v. Flynt*, 439 U.S. 438 (1979) (attorney's right to be admitted to practice out of state on a case-by-case basis held not a property or liberty interest protected by due process). Thus, procedural due process analysis requires two determinations: first a determination that the interest at stake is of a kind protected by due process; and second, a determination of what kind of process is due such an interest.

[249] E.g., *Vitek v. Jones*, 445 U.S. 480 (1980); *Board of Regents v. Roth*, 408 U.S. 564 (1972); *Goldberg v. Kelly*, 397 U.S. 254 (1970). See generally, L. Tribe, *American Constitutional Law*, 677 (2d ed. 1988).

[250] *Fuentes v. Shevin*, 407 U.S. 67, 86-87 (1972).

## 2. The Process That is Due

Although arguments have been made that procedural fairness should be required because of its "intrinsic value" in respecting the dignity interests of individuals by permitting them to participate in decisions which affect them, the Supreme Court has generally required procedural safeguards because of what has been termed their "instrumental value" in achieving accurate and efficient determinations of fact.[253] By and large, the Supreme Court has required the government to provide certain procedures as a means of assuring that society's rules governing behavior and the distribution of public benefits are, in fact, accurately and consistently applied. It has done so by adopting a kind of utilitarian, cost-benefit calculation in which the value to the individual of the procedure in question in reducing the risk of error is weighed against the cost to society of providing the procedure. Thus, in *Mathews v. Eldridge*, the

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[251] *Wisconsin v. Constantineau*, 400 U.S. 433 (1971) (posting of name as chronic drinker affecting legal right to purchase liquor held a protected liberty interest); *Paul v. Davis*, 424 U.S. 693 (1976) (distribution by police of flyers identifying individual as known shoplifter held not a protected liberty interest where no other interests protected by due process were implicated). See L. Tribe, *American Constitutional Law* 701-706 (2d ed. 1988).

[252] See, e.g.,, *Briggs v. Sullivan*, F.2d 1132 (10th Cir. 1989); *Jordan v. Schweiker*, Civ. Action No 79-994-W, Order of District Court Judge West at 9 (W. D. Okl. 1983); *Tidwell v. Weinberger*, Civ. Action Nos. 73-C-3014 and 74-C-183 (N.D. Ill. June 23, 1976); *McGrath v. Weinberger*, 541 F.2d 249 (10th Cir. 1976). These courts' application of the *Mathews v. Eldridge* balancing test would seem to require an implicit recognition that the interest at stake is sufficient to require a determination of the process constitutionally required.

[253] L. Tribe, *American Constitutional Law*, §10-7 (2d ed. 1988).

Supreme Court stated that the process that is constitutionally due can be determined by weighing:

> first, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used and the probable value, if any, of additional or substitute procedural safeguards; and finally the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.[254]

In the *Mathews* case, the Supreme Court held that an individual's interest in continued benefits under Title II of the Social Security Act was not of sufficient weight to merit the cost to the government of providing predetermination evidentiary hearings on demand before such disability insurance benefits were terminated. The *Mathews* Court viewed the procedures used by SSA in terminating Title II disability benefits as constitutionally sufficient. These procedures included notice and an opportunity to participate in the state agency's first "tentative" determination of continued eligibility by completing a questionnaire about one's condition and by submitting written statements.[255] The Court was impressed with the objective nature of the medical evidence upon which continued eligibility is based and thus found oral hearings of little additional value in producing more accurate determinations.[256]

The Court has employed this balancing test in most cases in which persons entitled to government benefits have claimed a due process right to certain procedures. Several lower federal courts have expressly applied the *Mathews v. Eldridge* test to the interest of social security beneficiaries in receiving direct payment of their benefits. Most often the cases were brought to establish a due process right to notice and to an oral, trial type hearing before an incapability determination is made. In each case, the court found that the decreased likelihood of error that greater procedural safeguards would afford was outweighed by the expense and inconvenience to the government of providing them. In *McGrath v. Weinberger*, plaintiff Title II and Title XVI beneficiaries brought a class action challenging the procedures used by SSA prior to 1976 to appoint representative payees.[257] The plaintiffs claimed that the procedures violated due process by not providing them with prior notice and an opportunity to contest the determination. The named plaintiff had been found to be incapable of managing benefits after he was discharged from a state mental hospital. The determination was based on a psychologist's opinion to that effect and the hospital administrator's report that McGrath spent his money foolishly. McGrath was given no notice or opportunity for a hearing prior to the determination. The trial and appellate courts agreed that application of the *Mathews v. Eldridge* test to the interests at stake indicated that prior notice and hearing were not required by due process before a determination was made that a representative payee was needed. Ignoring the fact that the plaintiff in *Mathews* had at least been given notice and some opportunity to submit evidence prior to the termination of benefits, the appellate court in *McGrath* reasoned:

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[254] *Mathews v. Eldridge*, 424 U.S. 319, 335 (1976).

[255] 424 U.S. 319, 324.

[256] As noted, SSA does not afford beneficiaries any opportunity to present evidence before an incapability determination, although it does provide an opportunity to be heard before the determination is implemented. See discussion at notes 198 to 221 supra.

> The private interest affected in this action is the free use of Social Security benefits. There is not a termination of benefits as there was in *Eldridge*, but rather a deprivation of free use of benefits. Since the Supreme Court in *Eldridge* held that due process was not violated by terminating benefits without prior opportunity for an evidentiary hearing, it would be an unwarranted departure on our part to hold that due process requires prior notice and an opportunity for a hearing where there has been no termination of benefits.[258]

The court went on to find that the risk of an erroneous deprivation of the free use of benefits was minimal where determinations were based primarily on good faith evaluations by psychologists who had observed the beneficiary. In addition, the court noted that the plaintiffs had available to them fair and adequate post-determination procedures for review of the decision. Finally, it found the governmental interest in avoiding the time and expense of prior oral hearings was substantial and outweighed the plaintiffs' interest.

A three-judge court in *Tidwell v. Schweiker* came to the opposite conclusion with regard to pre-1976 process but approved SSA's revised procedures, which are substantially the same as those in effect at the present time. In *Tidwell*, plaintiffs were patients in a state mental hospital entitled to receive social security disability benefits. They claimed that the federal and state scheme for appointing the superintendent of the institution as representative payee for incompetent patients who had no family members able to serve, without notice or an opportunity to submit evidence, violated due process.[259] The district court found that the procedures used to appoint a payee did violate due process standards.[260] The court weighed the different factors required by *Mathews* and found that the present administrative process "obviously lacks any procedural safeguards."[261] Its conclusion was not evaluated by the appellate court, however, because subsequent to the decision, both the state and the federal government changed their procedures, and the three judge court amended its order, finding the revised federal procedures comported with due process. The court noted that "although need stage hearings would provide the greatest safeguards, they [are] not constitutionally required."[262]

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[257] *McGrath v. Weinberger*, 541 F.2d 249 (10th Cir. 1976).

[258] *Id.* at. 253.

Finally, in *Jordan v. Schweiker*, the lower court rejected plaintiffs' claims that the post-1976 procedures for appointment of representative payees violated due process. The plaintiffs brought a class action challenging SSA procedures that gave advance notice of the implementation of incapability determinations but not an opportunity for an oral hearing prior to the initial selection or continuation of a payee. They contended that limiting beneficiaries to written objections before appointment of a payee did not adequately protect beneficiaries from the risk that an incompetent or untrustworthy payee would be appointed. Expressly applying the *Mathews v. Eldridge* test, the court found that first, plaintiffs' interest in control over their benefits was "substantial," second, the risk of error under the present procedures was slight and the provision of an oral hearing prior to the selection of a payee would not significantly reduce the risk of possible error, and third, the procedures were "in balance with the Government's fiscal and administrative burden."[263]

As evidence that there is little general dissatisfaction with the appointment of representative payees, SSA submitted in *Jordan* the results of a study it had undertaken of all initial and post-entitlement representative payee determinations between January 1977 and June 1979. Of more than 52,000 determinations made at the time of the initial claim of entitlement, that representative payees were needed, less than 2 percent were protested. Of those protested, about one-half were overturned by SSA. Of the 287,000 post-entitlement determinations, 4 percent were protested and again, about one-half were reversed by SSA. The court was impressed by these figures and quoted *Mathews v. Eldridge* to the effect that "procedural process rules are shaped by the risk of error inherent in the truth-finding process as applied to the generality of cases, not the rare exceptions."

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[259] *Tidwell v. Schweiker*, The plaintiffs also challenged the constitutionality of the state's practice of requiring competent patients to sign a form permitting the state to accumulate disability benefits and use funds in excess of $400 to pay for their support in the institution. Both the lower and appellate courts found this arrangement violated the prohibition in section 407 of the Social Security Act against assignment of disability benefits. *Id.* at 566.

[260] *Id.*

[261] *Tidwell v. Weinberger*, 73-C-3014 and 74-C-183 at 17 (N.D. Ill. 1976).

[262] *Id.* at 16.

[263] *Jordan v. Weinberger*, Civ.-79-994-W at 13 (W. D. Okl. March 17, 1983).

On the other hand, the infrequency of protests would seem to minimize the aggregate expense to the government of providing waivable opportunity to participate *before* the determination. Its relevance seems to be premised on the notion that the low protest rate and 50 percent reversal rate indicates that few errors are made under present procedures. As noted, other factors may also contribute to low protests rates, such as the vulnerability of these beneficiaries because of their age, disabilities and low incomes, as well as their lack of access to legal services or other representation.[264] Furthermore, if the 50 percent error rate were representative of that of all representative payee determinations, mass injustice would, indeed, be occurring.

### a. Notice

There is no question that the due process clause requires that both notice and some opportunity to be heard be provided before one is deprived of a government benefit.[265] The issue is when and how the notice and opportunity must be provided. Neither the Social Security Act nor the APA impose notice requirements on SSA with regard to the informal adjudication involved in making representative payee determinations. As discussed above, SSA's current practice, as indicated in the POMS, is to provide an "advance notice" after a claims representative has made a determination that a beneficiary is incapable of managing funds and has selected a payee but before the determination is implemented by payment to the payee.[266] The practice of sending "advance notice" after a determination of incapability has been made is arguably inconsistent with the procedures set forth in SSA regulations, which provide that the beneficiary will be given advance notice of "proposed action." While proposed action could mean either the determination of incapability or payment to a representative, the regulations leave the impression that notice will be given prior to any determinative action by the agency. The determination that a beneficiary is in need of a payee is the decisive one. Once that determination is made, payment to a representative is required if a payee can be found.

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[264] Mitchell, "Involuntary Guardianship for Incompetents: A Strategy for Legal Services Advocates," 12 Clearinghouse Review 45 (1978). A field study of 600 guardianship cases in New York disclosed no appeals of trial court findings of incompetence, cited in G. Alexander and T. Lewin, *The Aged and the Need for Surrogate Management* 29, n. 24 (1972). Cf. *Gray Panthers v. Schweiker*, 652 F.2d 146, 166 (D.C.Cir. 1980).

[265] *Zinermon v. Burch*, 110 S. Ct. 975, 985 (1990); *O'Bannon v. Town Court Nursing Center*, 447 U.S. 773, 780 (1980) (the right to notice and a hearing on a claim to government benefits called "general due process maxim"); *Wolff v. McDonnell*, 418 U.S. 539, 557-58 (1974) ( notice and "some kind of hearing is required at some time before a person is finally deprived of his property interests").

[266] "The notice may be sent only after incapability has been established and a proposed representative payee has been chosen." POMS §00502.310, B, 2 (1989). SSA's practice of mailing advance notices to the last known address of the parties determined to be entitled to notice would seem to meet constitutional requirements that the method of notification be "reasonably calculated, under all the circumstances," to apprise interested parties of the pending

The purpose of notice to beneficiaries whose interests are affected by certification determinations is to permit them to provide the agency with information relevant to the determination. Thus, in *Mullane v. Central Hanover Bank & Trust Co.*,[267] the Supreme Court stated that due process requires notice to be reasonably calculated, under all the circumstances, to appraise interested parties of the pendency of the [judicial] action and afford them an opportunity to present their objections."[268] SSA's "advance notice," provided only after an incapability determination has already been made, does not afford the beneficiary notice of the pending determination or an opportunity to present objections.

Furthermore, the advance and formal notices used by SSA provide little information that would be useful to a beneficiary interested in knowing on what grounds one might object or protest the impending action. The notice states neither the standard of incapability applied nor the reasons why the beneficiary has been determined not to meet it. SSA's notice explains only that "the facts we have show that this would be best for you." The open-ended "best for you" is no more informative of the basis upon which the determination has been made than is the "interest" standard provided in the Act or the "capability" standard used by the Secretary. A recipient would be hard-pressed to know what additional facts to give the agency. However, without the formulation of a more determinate standard by the Secretary, it may be difficult to provide beneficiaries with adequate notice of impending payee certifications.

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action. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950). The notice is written in common language, advises the recipient of the planned action, the action he or she may take in response, the time within which such response must be made and provides the recipient a telephone number to get further explanations and an enclosed envelope addressed to the proper SSA field office in which to reply.

[267] 339 U.S. 306, 314 (1950).

[268] Nowak et al, supra note 138 at §13.8.

### b. A Predetermination Hearing

Although the court of appeals in the *McGrath* case held that due process required neither notice nor an opportunity to be heard before SSA renders a capability determination, that holding would seem to be contrary to the holdings in a number of other circuit court and Supreme Court cases. *Mathews v. Eldridge* did not hold that no predetermination process was due. It held only that due process did not require a full evidentiary hearing before the termination of Title II benefits. Rather, it held notice and an opportunity for written review before the termination was adequate where an oral, trial type hearing was also available after termination.

The hearing issue involves at least two interrelated subissues: (1) what kind of a hearing is required (what attributes must it have, including the opportunity to present oral testimony) and (2) when is it required--at stage one, before a determination of need has been made; at stage two, before implementation by payment to the payee; or at stage three, after payment has been made to the payee. The "what" and "when" hearing issues are interrelated in that the presence, absence and character of an opportunity to be heard at one stage affects the need for such an opportunity at another stage of the proceedings. Currently, SSA provides no opportunity to be heard at stage one,[269] an opportunity to review written evidence, submit new evidence and ask for an explanation of the agency's plans at stage two,[270] and an opportunity for a full oral hearing before an ALJ at stage three.

Whether SSA is required by due process to provide a opportunity to participate in the determination that a payee is needed has been confused by the fact that courts have often not made clear whether they were using the term "determination" to mean determination of incapability or payment to a payee. The lower court in the *Tidwell* case found that the absence of both notice and an opportunity to be heard before a determination was made was violative of due process.[271] The court of appeals in *McGrath v. Weinberger* did not agree and held that due process required neither. The district court in the *Jordan* case held that due process did not require a full trial-type hearing prior to an incapability determination and the court of appeals did not address the issue.

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[269] Except in certain high risk situations, and where no legal or medical evidence is available, SSA does not even require claims representatives to conduct a face-to-face interview with a beneficiary for whom representative payment is proposed to obtain information relevant to the decision. POMS 24 §GN 00502.050 B, 5, and §GN 00502.170, A, 3 (1989).

[270] Beneficiaries are not explicitly told in SSA's advance notice whether they are entitled to present their views on the appointment of a payee in person to the individual who has made the decision. Rather they are invited to contact any social security office to ask for further information.

[271] *Tidwell v. Weinberger*, Nos. 73-C-3014 and 74-C-183 at 17 (N.D. Ill. 1976).

Nevertheless, all three courts rejected the argument that due process requires a trial type hearing in every case (similar to that provided in state guardianship proceedings), prior to an incapability determination[272]. Since SSA procedures do include a hearing before an ALJ with many of the attributes of a trial type hearing at stage three, **after** an incapability determination has already been made and implemented, the remaining question is, does due process require any additional opportunity to participate in and affect a capability determination **before** it is made and/or before it is implemented. That is, does due process require more than the opportunity that is currently afforded, which is the opportunity to submit evidence to the claims representative decisionmaker at stage two, after a determination has been made but before it is acted upon?

An application of the *Mathews* balancing test to this question would seem to favor the provision of notice and some opportunity to be heard prior to the capability determination, rather than simply prior to its implementation. As some commentators have observed, "[T]here is no uniformity as to the nature of the procedures required to give someone due process,"[273] and the *Mathews* criteria for determining requisite procedures has been severely criticized for providing little predictability.[274] They point out, however, that the Court requires more process, including predetermination hearings, the greater or more significant the individual interest to be protected.[275]

If the beneficiary's interest in controlling expenditures is seen as the trigger for due process requirements, then allowing submission of evidence and review of the written record before agency action is taken should assure sufficient accuracy to be sustained under the *Mathews* test. This would be particularly so, if the opportunity to protest is construed to include a right to make an oral presentation to the decisionmaking claims representative why representative payment should not be ordered. If, on the other hand, beneficiaries have a protected liberty interest in not being determined incapable, apart from their interest in controlling expenditures, the question is whether SSA must provide notice and an opportunity to be heard at stage one, before the capability determination alone is made. In both *Tidwell* and *Jordan*, the courts reviewed current SSA procedures, including its regulations permitting objecting beneficiaries the opportunity to review and submit evidence relevant to SSA's "planned action." Their conclusion that these procedures were constitutionally sufficient may, however, have been premised on the understanding that the opportunity to be heard, even if only on paper, was provided before the determination to make representative payment was made.[276] That is not SSA practice, as discussed above.

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[272] See discussion at notes 257 to 264 supra.

[273] J. Nowak, R. Rotunda and J. Young, *Constitutional Law*, 506 (1986).

[274] See generally, Stone, Seidman, Sunstein and Tushnet, *Constitutional Law*, 917-21 (1986).

[275] *Id.* at 919 discussing *Cleveland Board of Education v. Loudermill* 470 U.S. 532 (1985).

It can be argued that beneficiary interests are little affected by an SSA determination of incapability, before a payee is actually appointed. Because the determination is not publicized in any way, it does not affect the beneficiary's standing in the community or reputation, and until it is implemented, it does not affect his or her control over benefits. However, what the determination does do is burden any subsequent efforts to avoid the appointment of a representative payee. As Professor Tribe has pointed out:

> Institutional pressures and commitments tend to militate against reversing even those deprivations that have not yet worked irreparable harm, since the governmental decision-maker may have acquired a vested interest in ratifying an action already taken. [277]

Nevertheless, the private interest is only one of the three factors in the *Mathews* calculus. Recently, in *Zinermon v. Burch*, 110 S. Ct. 975, 985 (1990), the Supreme Court summarized its application of the *Mathews* test by focusing on the second factor, the accuracy-producing value of the proposed procedures.[278] Thus, as in *Mathews v. Eldridge*, the Supreme Court has held in some situations that due process requires no predetermination oral hearing for affected individuals where post-determination full hearings and state remedies were available to assure an accurate, albeit retrospective, application of law to facts and compensation for injury.[279]

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[276] For example, in denying the claim that due process required more, the district court in the Jordan case stated that "Under these procedures, prior to a determination that a beneficiary is in need of a representative payee and prior to the selection of a payee, the SSA provides all adult beneficiaries who have not been adjudged legally incompetent with advance notice of the proposed determinations.". Order, Civ-79-994-W, p. 5 (March 17, 1983). (Emphasis added).

[277] Tribe, *Constitutional Law*, (2d ed. 1988). Such inertia may be especially harmful in the case of representative payment because the interest of beneficiaries in controlling the use of their benefits can become an interest in subsistence itself if an incapability determination results in a suspension of benefits when a payee cannot be found.

As discussed more fully below, except in California where the practice has been enjoined by the *Briggs v. Sullivan* case, SSA may suspend benefits for up to 90 days when it is determined that it is in the interest of the beneficiary to have a payee but no suitable payee can be found. POMS §§GN 00504.100 and GN 00504.225 (1986). In *Goldberg v. Kelly* the Supreme Court found that termination of benefits "pending resolution of a controversy over eligibility may deprive an eligible recipient of the very means by which to live while he waits. Since he lacks independent resources, his situation becomes immediately desperate." 397 U.S. 254, 264 (1970). This would be particularly true of the Title XVI beneficiaries found to need payees, although under the statute, SSA does not have authority to pay directly those Title XVI beneficiaries receiving disability assistance based on their drug or alcohol addiction.

[278] The Court said:

SSA does provide a post-implementation oral hearing before an administrative law judge on the questions of capability and the selection of a payee.[280] That hearing is in essence a full evidentiary hearing; it permits the beneficiary to be represented by counsel, submit written and oral testimony, receive a written determination by a neutral decisionmaker and obtain a record of the proceeding to use on appeal.[281] It would be a mistake, however, to assume that such post-determination process necessarily forecloses

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> The Court usually has held that the Constitution requires some kind of a hearing before the State deprives a person of liberty or property. [citing Cleveland Board of Education v. Loudermill, 470 U.S. 532 (1985); Parham v. J. R., 442 U.S. 584 (1979); Memphis Light, Gas and Water Div. v. Craft, 436 U.S. 1 (1978); Goss v. Lopez, 419 U.S. 565 (1975); Tolff v. McDonnnell, 418 U.S. 539 (1974); Fuentes v. Sheven, 407 U.S. 67 (1972); and Goldberg v. Kelly, 397 U.S. 254 (1970).] In some circumstances, however, the Court has held that a statutory provision for a postdeprivation hearing or a common-law tort remedy for erroneous deprivate satisfies due process. [citing Logan v. Zimmerman Brush Co. 455 U.S. 422 (1982); Memphis Light, supra; Ingraham v. Wright, 430 U.S. 651 (1977); and Mitchell v. W. T. Grant Co., 416 U.S. 600 (1974)(emphasis in the original).

*Zinermon v. Burch*, 110 S. Ct. 975,988 (1990). Finding that Florida officials had failed to establish procedures for determining the competency of mental patients to consent to commitment, which would have prevented the predictable deprivation of liberty that the plaintiff alleged, the Court held that an incompetent person so committed had a cause of action under section 1983 for deprivation of his rights secured by the Constitution. *Id.* at 988-89.

[279] See e.g., *Ingraham v. Wright*, 430 U.S. 651 (1977) (liberty interest of child subject to physical punishment in school protected by possibility of subsequent tort suit); *Hudson v. Palmer*, 468 U.S. 517 (1984)(property interest of prisoner protected against action by prison officials by state law remedies for intentional destruction of property) and see J. Nowak, R. Rotunda, and J. Young, Constitutional Law 512 (3rd ed. (1986). "It is possible for a court using the Mathews balancing approach to determine that some types of deprivations of liberty or property can be justified without a predeprivation process, or with very informal or limited predeprivation procedures, if the individual whose interest is being taken by the government receives a subsequent (post deprivation) process for review of the decision and possible restoration of that interest."

[280] See discussion notes 214 to 220 supra.

[281] *Id.*

constitutional requirements for predetermination process. In *Zinermon v. Burch*, the Supreme Court held that post-determination remedies of state tort law, including full evidentiary hearing, were not constitutionally sufficient. There, Florida had granted broad discretion to state officials, with little guidance, to deprive persons of their liberty by admitting them as voluntary patients to mental institutions. State officials could have, but failed to, establish predeprivation safeguards to prevent predictable, unlawful loss of liberty.[282] Willing to consider the value of predeprivation procedures in addition to post deprivation remedies, the Court found that such procedures were authorized by legislation, possible to devise, and valuable in preventing erroneous determinations regarding liberty interests.

Like the officials in *Zinermon*, SSA has been granted broad discretion to deprive social security beneficiaries of a significant liberty interest and has been provided little statutory guidance in doing so. In addition, the significant determination to be made in both the *Zinermon* situation and representative payment is the competence or capability of an individual to, in the one case, give consent to commitment and, in the latter, to handle benefits. The *Zinermon* Court in effect held that the Constitution requires the promulgation of feasible, predeprivation procedural safeguards to prevent predictable errors. So SSA would seem to have a constitutional obligation to promulgate feasible, predeprivation (stage one and stage two) procedural safeguards to prevent erroneous determinations in favor of representative payment. Unlike Florida officials, SSA provides some procedural safeguards before implementation of its procedures. Presently, these include protest procedures which permit the beneficiary to review and submit written evidence to the decisionmaker. Whether these procedures are adequate to protect the liberty interests at stake is determined in accordance with the *Mathews* test.

In *Mathews*, the Court distinguished the earlier case of *Goldberg v. Kelly*, regarding pretermination hearings in welfare cases, by not only finding the beneficiaries' interests in Title II benefits of lesser weight than the welfare benefits in *Goldberg*, but also by weighing the value of procedures in producing accurate determinations. In doing so, it was impressed with the protections afforded by the fact that the disability determinations at issue in *Mathews* were based largely on written medical evidence, while the welfare determinations at issue in *Goldberg* were not.[283] Like welfare entitlements,

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[282] ___ v. ___, 110 S.Ct. 975 (1990).

[283] Professor Mashaw has found problematic the Court's characterization of disability determinations as founded on unbiased medical reports and documentary evidence, because the determination becomes a highly judgmental process requiring functional assessments and their affect on required capacities. Mashaw, "The Supreme Court's Due Process Calculus for

SSA incapability determinations are not made on the basis of empirical medical findings, but rather on the personal opinions of physicians and claims representatives about how much functioning a person needs to live adequately in the community. This determination may often depend on a wide variety of evidence and the witnesses' credibility. Providing an opportunity to participate in the incapability determination would presumably decrease the likelihood of error by some degree (at least to the extent that it eliminates the inertia that a beneficiary must overcome when only post-determination review is possible).

Although not a constitutional decision, the Supreme Court's decision in *Califano v. Yamasaki* also raises serious questions about SSA's failure to provide beneficiaries with an opportunity to discuss payee determinations face-to-face with a decisionmaker before an incapability determination is made.[284] In order to avoid unnecessary constitutional adjudication, the Supreme Court decided the *Yamasaki* case on statutory grounds, but its reasoning is relevant to due process analysis and to construction of the Social Security Act. In *Yamasaki*, the Supreme Court recognized that where Title II benefits ("required for ordinary and necessary living expenses") were at issue, a written review, prior to a determination not to waive recoupment of overpayments, was insufficient. By statute, the Secretary's determination whether to waive recoupment of overpayments turned on an assessment of fault, equity and good conscience. Finding that those determinations depended on an evaluation of "all pertinent circumstances, including the recipient's intelligence and physical and mental condition as well as his good faith," the Court stated:

> We do not see how these can be evaluated absent personal contact between the recipient and the person who decides his case. Evaluating fault, like judging detrimental reliance, usually requires an assessment of the recipient's credibility, and written submissions are a particularly inappropriate way to distinguish a genuine hard luck story from a fabricated tall tale. Id at 697.

The Court held that the statute did not permit recoupment from a person who qualifies for a waiver, and, thus, the statute itself required an oral hearing on the waiver **before** recoupment, (though not an adversarial evidentiary hearing).

The same might be said of sections 205(j) and 1631. The Secretary is authorized only to certify representative payment "when the Secretary

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Administrative Adjudication in *Mathews v. Eldridge*: Three Factors in Search of a Theory of Value," 44 U. CHI L. REV. 28, 41-42 (1976).

[284] 442 U.S.682 (1979).

determines that the interest of an indivdual under this title would be served thereby."[285] Like waiver of recoupment, representative payment is authorized only after the Secretary has made a determination of "interest," which, like the waiver determination, necessarily turns on an evaluation of all pertinent circumstances and requires evaluations of credibility and explanations for past behavior. SSA's current protest procedure does not expressly provide an opportunity for an oral presentation of objections and seems to anticipate only a review of the written file.[286] Under *Yamasaki*, this procedure may be suspect. While the 1990 amendments clearly require a predetermination notice, it is not clear whether a hearing must be available before an incapability determination is made, or even before implementation.[287] *Yamasaki* would indicate that the statute must be construed to require an opportunity for an oral hearing prior to implementation and perhaps before determination of incapability.

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[285] 42 U.S.C. §405(j). and 1383(a) is amended by Pub. L. No. 101-508, §5105.

[286] It requires that protests stating the reasons for objection be made in writing and that the adjudicator review all of the factors leading to the decision and any new evidence submitted. POMS §GN 00501.400 (1989).

[287] The amendments provide:

> "(E)(i) Any individual who is dissatisfied with a determination by the Secretary to certify payment of such individual's benefit to a representative payee under paragraph (1) or with the designation of a particular person to serve as representative payee shall be entitled to a hearing by the Secretary to the same extent as is provided in subsection (b), and to judicial review of the Secretary's final decision as is provided in subsection (g).
>
> "(ii) In advanced of the certification of payment of an individual's benefit to a representative payee under paragraph (1), the Secretary shall provide written notice of the Secretary's initial determination to certify such payment. Such notice shall be provided to such individual, except that, if such individual--
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> "(I) is under the age of 15,
>
> "II) is an unemancipated minor under the age of 18, or
>
> "(III) is legally incompetent,
>
> then such notice shall be provided solely to the legal guardian or legal representative of such individual.

OBRA 1990 §(a)(1)(E) to be codified at 42 U.S.C. §405(j).

Finally, in considering the third factor, the government's interest (including the burden of additional procedures), the Court in *Yamasaki* found that the cost of providing full evidentiary predetermination hearings was significant. Among the costs that would have been borne by the government in *Mathews* had predetermination hearings been required, was the cost of erroneously continuing to pay benefits, until a hearing could be held. These continued benefits would often be paid to low income recipients from whom it could not likely recover erroneous payments. In the case of representative payment, the cost to SSA of providing beneficiaries an opportunity to present oral evidence before a determination would not seem any greater than the cost of providing the same opportunity after the determination. Unlike its situation in *Mathews*, SSA does not bear any additional cost in the form of continued erroneous payments if payee determinations are delayed by the need for a predetermination hearing. A predetermination oral hearing in the form of a face-to-face discussion with a claims representative would be required in most cases, however, rather than only those cases in which the beneficiary was dissatisfied with SSA's determination.[288] Thus, although the liberty and property interests at stake in representative payment may not weigh as heavily as the interests at stake in *Goldberg* and *Mathews*, the value of additional procedural safeguards in the form of an opportunity for a face-to-face interview at stage one would seem to be great, and the additional costs to the government of requiring such safeguards would be small. For these reasons and the reasons supporting the Supreme Court's decision in *Zinermon*, additional predetermination procedural safeguards may be required in representative payment determinations.

In those cases in which postdetermination remedies have not been found to be constitutionally sufficient, due process may be satisfied by a number of different predetermination procedures.[289] In many contexts the opportunity to appear personally, present and comment upon evidence, make arguments, receive explanations of agency action and otherwise participate in decisionmaking process has been held to provide a due process hearing, even though it falls short of a full trial-type hearing.[290]

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[288] The Court in *Yamasaki* did not find that requiring a predetermination oral hearing imposed an inappropriate administrative burden, in part because the hearing was an informal face-to-face meeting, rather than a formal adversarial hearing. The Court noted that in complying with the District Court's order for predetermination oral hearings, SSA had granted "a short personal conference with an impartial employee of the Social Security Administration at which time the recipient presents testimony and evidence and cross examines witnesses, and the administrative employee questions the recipient." 442 U.S. 682, 697 (1979).

[289] L. Tribe, *American Constitutional Law* 719 (2d ed. 1988). Professor Tribe cites the following cases in which postdetermination hearings have been found inadequate by the Supreme Court: *Perry v. Sindermann*, 409 U.S. 593 (1972); *Morrissey v. Brewer*, 408 U.S. 471, 475-476 (1972); *Fuentes v. Sheven*, 407 U.S. 67, 76-77 (1972); *Stanley v. Illinois*, 405 U.S. 645, 647-49 (1972); *Bell v. Burson*, 402 U.S. 535 (1971); *Goldberg v. Kelly*, 397 U.S. 254 (1970); *Sniadach*

A predetermination opportunity for an oral hearing (in the form of a face-to-face interview) would seem desirable in the representative payee program for several reasons. First, since representative payment is premised on the assumption that indirect payment is justified only as a benefit to the social security recipient, the government not the recipient should bear the risk of error. (Indeed, the government has recognized this principle by making determinations not to appoint a payee nonappealable.) Requiring more accurate determinations of statutory standards of beneficiary interests is the essence of the Supreme Court's *Zinermon* holding. Many beneficiaries proposed for representatiave payment are old, ill, otherwise impaired and poorly educated. It is unrealistic to expect them to communicate their concerns about representative payment effectively in writing. Second, such a requirement would not seem to impose significant additional costs on SSA, which already provides notice and an opportunity to be heard at a later stage in the administrative process. Beneficiaries who welcome the appointment of a payee will presumably waive the opportunity to discuss the prospect in person with an SSA representative, thus minimizing the costs of providing an opportunity for a face to face interview. In representative payment cases, SSA has no fiscal interest in delaying hearings until after a determination of incapability is made because full benefits are paid continuously, regardless of the determination, unless a payee cannot be found. Finally, such predetermination procedures should enhance respect for the adjudicatory

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*v. Family Finance Corp.*, 395 U.S. 337 (1969). Cases in which no prior hearing was required often involved conflicting property rights in the same subject matter, e.g.,, *North Georgia Finishing, Inc. v. DiChem, Inc.*, 419 U.S. 601 (1975) or state judicial remedies were available to compensate and deter illegal government action, e.g.,, *Ingraham v. Wright*, 410 U.S. 651 (1977), neither of which apply to representative payee determinations.

[290] Thus, although in *Goldberg v. Kelly*, supra, the threatened loss of subsistence benefits triggered the requirement for a full trial-type hearing before termination, in *Bell v. Burson*, 402 U.S. 535 (1971) the loss of a driver's license required a less than full trial-type prior hearing to determine the probability of a judgment against an individual involved in a traffic accident that would require proof of his financial responsibility, and in *Goss v. Lopez*, 419 U.S. 565 (1975) the school required the students be afforded some opportunity to explain their position to school officials prior to their disciplinary suspensions, even if it was only a chance to explain minutes after the incident at issue.

process by the public and those affected by it, permitting more timely and effective participation.[291] As stated by Judge Wald:

> Perhaps the most important reason for generally insisting upon an oral hearing is that no other procedure so effectively fosters a belief that one has been dealt with fairly, even if there remains a disagreement with the result. Our system of government is founded on respect for, and deference to, the integrity and dignity of the individual. In the Government's dealings with individuals--especially with respect to those individuals' property rights--some mechanism must exist to ensure that those values are left intact, even when action is finally taken against the person. In a society like ours, which operates on the assumption of and relies for its continued stability on respect for our institutions and voluntary compliance with the dictates of law, it is crucial that its members perceive that their rights and interests are taken seriously and thoughtfully by the officials who are deciding their claims.[292]

### c. A Right To Counsel

One of the problems arising from the extension of due process rights to statutory entitlements such as social security benefits is the problem of providing a meaningful and effective hearing on a mass basis.[293] As the Supreme Court recognized in *Goldberg v. Kelly*, not only are relationships with the government increasing in number and importance to individuals, but also also in complexity. The right to a hearing is a hollow one if it does not include the opportunity to have the assistance of counsel when needed. Although social security beneficiaries have a right to be represented by counsel in representative payee determinations, they are not informed by SSA of that fact nor advised how they might obtain the assistance of a lawyer or nonlawyer representative. Further, either because the remuneration for representation before such agencies is not thought to be significant or because of lack of training or lack of numbers, the bar is unable to provide all of the assistance necessary. Consequently, many applicants for SSA benefits and beneficiaries are assisted by nonlawyers rather than lawyers in hearings before the agency. Although SSA beneficiaries have a right to be assisted in their dealings with the agency regarding representative payment by either a lawyer or a nonlawyer, they do not have a right to such assistance at the agency's expense.[294]

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[291] *Gray Panthers v. Schweiker*, 652 F.2d 146, 162 (1980).

[292] *Id.* (Medicare beneficiaries disputing the denial of claims of less than $100 held constitutionally entitled to be informed of or have access to evidence on which carrier relied and an opportunity to present evidence in support of their position in written form or in oral form if factual issues involving credibility or veracity were at stake.)

[293] See generally, Hostetler, "Nonlawyer Assistance to Individuals in Federal Mass Justice Agencies: The Need for Improved Guidelines," 2 ADMIN. L. J. 85 (1988).

SSA could do more to promote lay and professional representation of beneficiaries in disputes over representative payment. The Conference has recommended that SSA and other agencies take further action to clarify the entitlement of nonlawyers to fees and to protect them from prosecution under state unauthorized practice laws.[295] Advance notices of representative payee actions do not advise beneficiaries of their right to retain counsel or assistance from nonlawyers; provide a list of sources from which such assistance might be obtained free of charge; nor is it the agency's practice to otherwise provide that information unless requested by the beneficiary.[296] Finally, the agency must approve all fees paid for representation. In the case of disability determinations, fees may be paid out of the awarded benefits. The fact that no such benefits are available in representative payee cases with which to pay for representation, may help explain why few beneficiaries seem to be represented by counsel in representative payee matters. SSA should consider advising beneficiaries for whom representative payment has been proposed where they might seek legal and other assistance either on a paid or charitable basis.

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[294] *Toledo v. Secretary of HEW*, 435 F.2d 1297 (1st Cir. 1971); *Ware v. Schweiker*, 651 F.2d 408 (5th Cir. 1981). In *Goldberg v. Kelly*, 397 U.S. 254 (1970), the Supreme Court recognized that where essential public welfare benefits were at stake, persons entitled to hearings before the agency were constitutionally entitled to secure representation of counsel, although they were not entitled to publicly financed counsel. The APA allows each agency to determine for itself whether and under what conditions nonlawyers will be permitted to practice before the agency. 5 U.S.C. section 555(b) (1988); *Coyle v. Gardner*, 298 F. Supp. 609 (D. Haw. 1969). SSA has issued regulations permitting nonlawyer representation and such representatives may receive fee awards for their services. 20 CFR §404.1700 (1990); 42 U.S.C. §406(a) (1988).

[295] Conference Recommendation 86-1, "Nonlawyer Assistance and Representation," 1 CFR §305.86-1 (1990). A 1983 study by SSA indicated that in only 11.2 percent of requests for hearing were beneficiaries represented by nonlawyers. In 50.5 percent of the hearing requests, beneficiaries were assisted by lawyers and in 38 percent of the cases the participants were unrepresented. Persons familiar with the study indicated that the "overwhelming majority of nonlawyers were relatives and friends appearing without fee on a one-time basis or paralegals and other employees of nonprofit organizations." Hostetler, "Nonlawyer Assistance to Individuals in Federal Mass Justice Agencies: The Need for Improved Guidelines," 2 ADMIN. L.J. 85 (1988).

[296] Lawyers Co-operative Publishing Company, Social Security Law and Practice, section 46:5 (1987)

### d. The Burden Of Proof And The Standard Of Proof

While SSA regulations and practice presume capability until incapability is proved, they do not indicate the standard of proof to be applied. The POMS provides that: "A beneficiary age 18 and older will be assumed to be capable unless SSA has information that the beneficiary may have a mental or physical impairment which prevents him/her from managing or directing the management of his/her benefits."[297] This provision is consistent with SSA regulations, which provide that: "Our policy is that every beneficiary has the right to manage his or her own benefits."[298] Implicit in this statement would seem to be the assumption that every beneficiary is presumed capable of managing his or her benefits. The presumption of capability is further borne out by the POMS provision that a Special Determination Form 553 must be prepared in those instances in which "[c]apability is established only because there is no convincing legal, medical, or lay evidence of either capability or incapability or there are contradictions which cannot be resolved." This provision suggests, but does not clearly state, that where the evidence is balanced or conflicting, the burden of proving incapability has not been sustained. Finally, SSA's actual practice seems to be premised on an assumption of capability.[299] This presumption of capability, implicit in the regulations and explicit in the POMS, places the persuasion burden on those proposing representative payment.

Unfortunately, this clarity is undercut by the fact that the regulations do not specify the amount of information SSA will consider sufficient to overcome the presumption of capability. It is unclear what standard of proof must be met before the factfinder may make a finding of incapability. While standards of proof are difficult to articulate, they establish the degree of belief (in the mind of the factfinder) concerning a fact that is required by law for its proof. The Social Security Act provides that the need for representative payment must be supported by "adequate" proof.[300] This term "adequate evidence" is not defined in SSA regulations. The regulations do not directly address the question of the standard of proof to be applied at any step of the process for determining incapability. The regulations and POMS indicate the **kind** of information the agency will consider in determining whether the beneficiary's interest will be served by representative payment, but not **how much** evidence will be sufficient to support a determination that representative payment is needed.[301] In effect, SSA's evidentiary standard of capability provides for the creation of irrebuttable presumptions or conclusive proof of incapability when certain evidence is presented (such as a physician's opinion), eliminating the application of a preponderance of the evidence test or an "adequate evidence" standard of proof. Yet, the POMS confusingly provides that lay evidence will be considered convincing when it is set forth in a Special Determination Form 553, without regard to the "adequacy" of that evidence.

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[297] POMS §GN 00502.040, B, 1 (1989). Neither the Social Security Act nor SSA regulations expressly state whether, once allegations of incapability are made, the persuasion burden, i.e., the burden of proving capability, is on the beneficiary or the burden of proving incapability is on the agency or those who propose representative payment.

[298] 20 CFR §404.2001(b) (1988); 20 CFR §416.601(b) (1990).

[299] Interview with Sheila Brown, Branch Manager, Social Security Field Office, Landover, Maryland, December 15, 1989.

[300] 42 U.SC. §405(j)(2) (1988) as amended by OBRA 1990. In 1984 Congress amended section 405 to provide that any certification of representative payment made under section 405(j): must be made on the basis of an investigation, carried out either prior to such certification or within forty-five days after such certification, and on the basis of adequate evidence that such

Supreme Court precedent suggests that a standard of proof higher than preponderance of the evidence is constitutionally required in representative payment. In *Addington v. Texas*, the Supreme Court held that where the state, in the exercise of its *parens patriae* powers, seeks to involuntarily commit a person to a mental hospital for treatment, the due process clause of the Fourteenth Amendment requires that it establish the applicability of the statutory standard for commitment by clear and convincing evidence.[302] Again using a balancing test, the Court reasoned that the individual's interest in avoiding the deprivation of liberty and stigma associated with commitment must be weighed against the state's interest in caring for citizens unable to care for themselves and in protecting society from dangerous mentally ill persons. The Court rejected the plaintiff's contention that proof beyond a reasonable doubt was required to justify the massive invasion of privacy involved in commitment, holding that the risk of error must be shared by the parties.

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certification is in the interest of the individual entitled to such payment (as determined by the Secretary in regulations). 42 U.S.C. §403 (Emphasis added)

While this provision is often regarded as a requirement that SSA investigate the qualifications of proposed payees, it is included in the section entitled "Determination and Monitoring of Need for Representative Payee." The qualifications of the payee do not go to the question of the need for a payee, and thus the provision ought to be read to require an investigation into the need for representative payment and a determination based on "adequate" evidence.

[301] 20 CFR §§404.2010 and 404.2015 (1990).

[302] Addington v. Texas, 441 U.S. 418 (1979). In judicial forums, the three most common standards of proof are "the preponderance of the evidence," the lowest standard; "clear and convincing evidence," the intermediate standard; and "proof beyond a reasonable doubt," the highest standard. The latter standard is applied in criminal cases, while the lowest standard is applied in most civil suits between private litigants. The intermediate standard is used in some cases in which the state acts in a civil capacity in such a way as to deprive citizens of important rights.

While the highest standard of proof would protect individual interests in liberty to the greatest extent, it would unduly burden effectuation of the state's interest.

The application of this balancing test to the adjudication of the right to control entitlements would seem to require a similar result. As in *Addington*, the government seeks to limit the liberty and property interests of an individual to benefit that individual, upon a finding that the person is mentally incapable of benefiting himself. While the interest of beneficiaries in controlling their benefits is not as great as the liberty interest of individuals diminished by physical confinement in an institution, society's interest in representative payment is correspondingly weaker than its interest in confining dangerous, mentally ill persons. Since the clearest and probably strongest interest of the government in representative payment is its interest in caring for those who cannot care for themselves, it can be argued that government, not those persons, must bear the risk of error.[303] Such an argument proceeds on the premise that liberty interests are a priori and an interference by the state must be justified. Ultimately, the answer to this procedural question, like the others, is dependent upon the values assigned to an individual's right to determine his or her own welfare and society's right to assist dependent citizens.

## VI. Standards Procedures For Selecting Payees

SSA's selection and monitoring of payees illustrates the agency's institutional ambivalence about the interests in tension in the representative payee program. At the same time that SSA provides essentially duplicative postdetermination procedural safeguards governing the need for and selection of payees, it is unable to assure the provision of appropriate payee services--leaving the interests of vulnerable beneficiaries in both self-determination and the receipt of needed assistance only partially served. For example, beneficiaries have a right to contest the appointment of particular payees after they have been appointed by the agency, but they cannot compel the appointment of a payee, whether or not they are found by SSA to be capable of managing their benefits. SSA's inability to find payees for vulnerable beneficiaries who are without family and other assets; its history of suspensing benefits in those situations; the difficulties of adequately investigating the integrity of proposed payees; its failure to provide administrative procedures to either beneficiaries or payees to appeal misuse determinations; and the administrative burdens of adequate payee accounting, all result in a program in which liberty interests are restricted for benevolent purposes but one which the agency is not in a position to assure benevolence through the selection and monitoring of payees.

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[303] Legislation was introduced, but never enacted, to clarify the applicable standard of proof in representative payee determinations. In October 1989, the Senate Finance Committee reported a bill that would modify the requirement of "adequate" evidence supporting certification of representative payment in the present law and require instead that certification be based on "substantial" evidence--a higher standard of proof. Senator Pryor introduced S. 1130 on June 6, 1989 which contained many reforms of the representative payee program. The bill did not contain a provision regarding the standard of proof to be required for certification of representative payment. 135 Cong. Rec. (June 6, 1989). However, the Senate Finance Committee amended the bill in committee and reported a bill containing such a provision. "The Social Security and Supplemental Security Income: Representative Payee Reforms," Press Release, Senate Finance Committee, 101st Cong. 1st Sess. (October 4, 1989). The OBRA 1990 amendments retain the 1984 "adequate evidence" standard.

## A. SSA Standards

The determination of incapability and selection of a payee often occur simultaneously. The appointment of a representative payee is usually initiated when a friend or relative of a beneficiary files an SSA-11BK form describing his or her relationship to the beneficiary and stating why it would be in the beneficiary's interest that the applicant be appointed representative payee.[304] Until the 1990 amendments, the Social Security Act provided that payment could be made to "a relative or some other person or organization," but did not otherwise set forth criteria to be used in selecting payees.[305] However, the Act did require that SSA investigate potential payees prior to their appointment to determine whether their appointment is in the beneficiary's interest. The 1990 amendments prohibit the appointment of certain persons and organizations, including those who have been convicted of social security fraud, removed as representative payee for another beneficiary, or are creditors of the beneficiary (with certain exceptions). Although it is SSA's policy to appoint the person, agency or institution that will best serve the interests of the beneficiary, the statute and regulations do not make it clear what procedures should be followed to discover who that person would be. Nor do SSA regulations indicate what kind of outreach efforts are appropriate to find persons who might be payees for particular beneficiaries or who might be better payees than the person who has petitioned to be appointed.

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[304] POMS §GN 00502.160,A,1 (1989). See form SSA-11-BK. The 11BK also requires that applicant to state that he or she is aware of the reporting responsibilities, that he or she is willing to carry them out and that he or she understands his or her liability for any overpayment for which he or she is at fault. POMS §GN 00502.160,A,2 (1989).

[305] OBRA 1990(a)(1)(A) and (B)(2) to be codified as 42 U.S.C. §§405(j)(1) and 1383(a)(2)(B) (1990) amending 42 U.S.C. 405(j) and 1383()(2) (1988).

SSA regulations do set forth certain factors that SSA will consider in evaluating potential representative payees. They include: the relationship between the parties, any legal authority the potential payee has to act on behalf of the beneficiary, the amount of interest that the potential payee shows in the beneficiary, whether the potential payee has custody of the beneficiary and whether the potential payee is in a position to know of and look after the needs of the beneficiary.[306] Legal representatives are informed that they may file to be appointed payee, but will be appointed only if they will serve the interests of the beneficiary better than a family member or other interested person.[307]

Where a beneficiary incapable of handling benefits resides in a hospital, mental institution, nursing home or board-and-care home, conflict-of-interest problems arise. SSA cautions claims representatives about the problem but does not prohibit the appointment of such institutions or facilities when it would serve the beneficiary's interest.[308] Statutory guardians, such as institutions, which are authorized by legislation to act as guardians for persons in their custody but are not required to account for their stewardship, are not given the same standing as legal guardians who are individually appointed by and accountable to a court. Institutionalized beneficiaries may have representative payees other than the superintendent of the institution. In fact, claims representatives are cautioned to consider the fact that in many cases, a custodial institution will be the primary creditor of a resident beneficiary and conflicts of interest may occur between the institution's fiduciary duties as representative payee to act in the beneficiary's best interests and its financial self-interest as prime creditor. The *Tidwell* case, discussed above, arose when a state institution sought, through consents and appointment as representative payees, to control the social security funds of residents so that they could be used to pay the cost of their maintenance.[309] The federal court in that case held the state and federal scheme unconstitutional. Since then, some states have extended the court's prohibitions by including in institutional licensing laws governing nursing homes and/or board-and-care homes, prohibitions against such institutions acting as a representative payee.[310] In the case of board-and-care homes, SSA requires claims representatives to check the lists maintained by states pursuant to the Keyes Amendment (section 1616(e) of the Social Security Act) of all such homes that fail to comply with state licensure requirements.[311] If a home complies with state licensing requirements, it may be appointed representative payee when it would be in the best interests of the beneficiary. A noncomplying home may be designated as representative payee only when all other potential candidates are unsuitable or not available, direct payment is prohibited or not in the beneficiary's best interest, and a face-to-face interview with the beneficiary has been conducted.[312]

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[306] 20 CFR §404.2020 (1988). These have been refined by SSA in the POMS to include: the potential payee's concern for the beneficiary's well being; his or her custody or physical proximity to the beneficiary; the family relationship between the payee and beneficiary, if any; any financial relationship between the parties that might raise conflicts of interest; and the legal relationship between the parties, such as guardianship. POMS §GN 00502.110,B,1 (1989). The POMS expressly notes that a legal guardian or conservator must receive notice of representative payee decisions affecting the ward, but that such legal representative may not necessarily be the best payee. POMS §GN 00502.110, B,1,e (1989).

[307] POMS §GN 00502.110, B,2 (1989).

[308] POMS §GN 00502.120, 150 and 180 A,3 (1989).

[309] See discussion at note 257-264 supra.

Where a capable adult beneficiary has petitioned for and obtained a conservator under state law, the conservator will be appointed representative payee at the beneficiary's request.[313] Otherwise, SSA will not appoint a representative payee for a competent adult who requests one, although it will directly deposit benefits to the beneficiary's bank account, which can then be accessed by a trustee, person with power of attorney or other fiduciary.[314] Social service agencies with legal custody of children may be appointed payee where parental rights have been terminated or visitation prohibited.[315]

Classes of potential payees are listed in preferential order by SSA to guide claims representative in their efforts to find payees and in their final selection.[316] The POMS emphasizes that this listing is to be used as a guide in identifying possible payees and is not be regarded as full "development" or a full investigation and selection process. The list pertaining to child beneficiaries contains seven classes of potential appointees based on their relationship to the children, whether they are supporting the child and whether they have demonstrated concern for the child.[317] The preferentially arranged classes for adult beneficiaries are: first, concerned spouses with custody or a legal guardian; second, a concerned friend with custody; third, an agency or institution with custody, a statutory guardian or voluntary conservator; fourth, a licensed for-profit institution with custody; and fifth, qualified and willing members of community groups who volunteer to serve, without reimbursement for services.[318] Where there are several potential representative payees with equal qualifications, additional factors are to be taken into account--each potential payee's past performance as payee, each potential payee's willingness to serve and, lastly, the wishes of the beneficiary.[319]

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[310] POMS §GN 00502.120,C (1989).

[311] POMS §GN 00502.120 (1989). Board-and-care homes are defined as nonMedicare/Medicaid residential facilities which provide room and board and continuous protective oversight. The level of care may vary from general supervision to intensive medical care. *Id.*

[312] POMS §GN 00502.120,C (1989).

[313] POMS §GN 00504.010 (1986).

[314] *Id.* and POMS §GN 00502.040,B,4 (1989).

[315] POMS §GN 00502.110, B, 2, b (1989).

[316] POMS §GN 00502.140 (1989).

There are some public and private organizations receiving federal funds from mental health block grants under the Public Health Service Act that must accept an appointment by SSA as representative payee for a Title XVI clients who are mentally ill and homeless, though not necessarily for Title XVI clients who are alcohol and drug abusers.[320] Nevertheless, not all mentally ill and homeless beneficiaries are clients of such organizations and finding payees for them is often difficult.

## B. Procedures For Investigating And Selecting Payees

### 1. The Duty to Investigate Payees

In 1984 and again in 1990, Congress amended the Social Security Act to require SSA to investigate the qualifications of proposed payees to receive representative payment before certification.[321] Prior to the 1984 amendment, at least one federal court had held that because the SSA had discretion with regard to the selection of a payee, it had no obligation to investigate or verify information provided to it by applicant payees.[322] SSA did not at that time request on its application form information about past performance as a payee or about criminal convictions. The 1984 amendments make such investigation mandatory. The Senate Report accompanying the provisions stated that:

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[317] 20 CFR §404.2021(b)(1988); POMS §GN 00502.140,B,1 (1990). The classes are: first, parents and spouses with custody and legal guardians; second, supporting parents without custody and social service agencies with legal custody; third, nonsupporting parents without custody; fourth, relatives and stepparents with custody; fifth, a concerned, supporting relative; sixth, a concerned relative or close friend; and seventh, an authorized social agency or custodial institution.

[318] 20 CFR §404.2021(a)(1988); POMS §GN 00502.140, B,2 (1989).

[319] POMS §GN 00502.110,B,3 (1989).

[320] POMS §GN 00502.130 (1989).

[321] 42 U.S.C. §405(j)(2) and 42 USC §1383 (a) (2) (B).

[322] Watson v. Califano, 487 F. Supp. 179, aff'd without opinion, 622 F.2d 577 (2d Cir. 1979)

> When Social Security Administration finds that such individuals cannot manage their funds, it has a serious obligation to exercise caution in selecting an alternate payee and to undertake reasonable efforts to assure proper use of and accountability for the benefits disbursed to that payee. The Committee amendment would establish a statutory base for that obligation of the agency.[323]

The amendments were enacted in response to a perception that an increasing number of beneficiaries in need of payees had no family members or close friends available to serve them. This perception would seem to be borne out by demographic information that indicates that larger numbers of deinstitutionalized, mentally ill persons and elderly persons in board-and-care homes are in need of representative payment. In 1984, Congress did not spell out what kind of investigation the agency is required to undertake to determine the qualifications of a payee. As discussed below, the federal district court in *Holt v. Bowen* held that even in the absence of regulations, the statute required that, at a minimum, such investigation must include a face-to-face interview with the proposed payee and background questioning.[324] The 1990 amendments to the Act require a face-to-face interview, documented proof of identity, social security number, and a determination of whether the applicant has been found guilty of social security fraud, or previous misuse of beneficiary funds.[325]

## 2. Procedures for Investigation And Selection

Prior to 1990 the statute did not set out and SSA did not promulgate, regulations delineating SSA's obligation to investigate proposed representative payees. As mentioned, the amendments now require SSA to conduct a face-to-face interview with each payee applicant where practicable and to obtain proof of the payee's identity, social security number and evidence that he or she is not disqualified by past convictions for social security violations.[326] The POMS instructs SSA personnel to develop the choice of payee by gathering certain information. A preferential listing of potential payees indicates persons who a claims representative might contact to find a suitable payee. Thus, SSA guidelines indicate that a legally appointed guardian should always be contacted and asked to file an application to be appointed payee or to defer the appointment to another candidate.[327] However, the claims representative is not bound to appoint a legal guardian as payee when another appointment would be in the beneficiary's best interest.[328] SSA suggests, but does not require, its claims representatives to conduct a face-to-face interview with an applicant payee.[329] The POMS also suggests that where an applicant does not have custody, the custodian should be contacted to provide corroborative evidence of the applicant's concern for the beneficiary.[330]

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[323] Social Security Disability Amendments of 1984, S. Rep. No. 98-466 to accompany S. 476, 98th Cong. 2d Sess. 29 (1984).

[324] *Holt v. Bowen*, 712 F. Supp. 813 (D. Colo. 1989)

[325] OBRA 1990 to be codified as 42 U.S.C. §405(j)(2)(B) (Supp 1990).

[326] 42 U.S.C. §405 (j) (2); 42 USC §1383 (a)(2)(B)

Although required to interiew each payee applicant, SSA requires that the beneficiary whose funds will be controlled by the payee be contacted only in high risk situations.[331] Thus, when the applicant has not been in close touch with the beneficiary in the last year and the beneficiary lives alone, in a proprietary residential facility that is not certified by Medicare or Medicaid or one that is certified but has been cited for abuse or substandard conditions, claims representatives are required to conduct a face-to-face interview with the beneficiary.[332] It is not clear why a face-to-face interview with the beneficiary is not routinely required to obtain relevant information and the beneficiary's opinion on which payee could best serve his or her interests although difficult to substantiate. Although difficult to substantiate, it is consistent with the agency's policy of not contacting the beneficiary until after a determination of capability and a selection of a payee has been made.[333] Perhaps it has been determined that the additional time required for a claims representative to conduct a face-to-face interview with the beneficiary in all representative payee cases is not merited by the amount of relevant information that would be obtained. Offering all beneficiaries an opportunity for a face-to-face interview would assure the agency that beneficiaries with relevant information would have an effective means of communicating it. It would also permit those who do not object to the appointment of a payee to waive it. In addition, as discussed elsewhere, apart from justifications based on accuracy and efficiency, such interviews can be justified as necessary to maintain the appearance of fairness and respect for beneficiaries.

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[327] POMS §GN 00502.140 and §GN 00502.150 (1989).

[328] Soc. Sec. Rul. 70-42.

[329] POMS §GN 00502.160,A,1 (1989).

[330] POMS §GN 00502.170,A,2 (1989).

[331] *Id.* POMS provides that a form 788 will be used to obtain information from the custodian, except in certain circumstances. If the form is not returned in 30 days, claims representatives are instructed to continue the claims process but follow-up after a determination has been made. POMS §GN 00502.170 (1989).

[332] POMS §GN 00502.160, B,1 and 00502.170, A,5(1989). Such personnel are given guidance in conducting those interviews. The POMS suggests that the interview be used for educational purposes as well as investigation.

[333] See discussion supra at note 269.

When claims representatives have found suitable payees, the payees are asked to file SSA-11BK applications to provide an adequate evidentiary basis for an appointment if they have not done so. This form asks for information concerning the applicant payee's residence; his or her relationship with the beneficiary, and the whereabouts of other relatives; whether the applicant lives with or has custody of the beneficiary and if not, why not; who supports the beneficiary; the proposed payee's source of employment and income; whether the payee is a creditor of the beneficiary, such as a nursing home, and in what amount; and whether the applicant has ever been convicted of a felony.[334] When someone applies to be payee but there are higher ranking potential payees, SSA will request applications from the higher ranking candidates. If there are competing applications for appointment as payee, claims representatives are required to explain why one applicant has been selected over another. If a payee is chosen who ranks lower than other representative payee candidates, the claims representative must document why the higher ranking candidate was not chosen. This can be done by indicating in the file that the nonselected candidate was unable or unwilling to serve as payee; that he or she was contacted and found not the best available payee, and the reasons therefore, or was not contacted but found not the best available payee on the basis of other information; or that the higher ranking candidate deferred to the selection of the lower ranking candidate.[335] When the selected payee is an institution, the claims representative must explain why a better qualified payee is unavailable, and if the institution has custody of the beneficiary, the claims representative must indicate that the office is satisfied that the institution will act in the beneficiary's best interests.[336]

Continued contact with the payee after certification is required in certain high risk circumstances. Thus, where a board-and-care home is appointed payee or a social agency has been granted temporary custody of a minor beneficiary and appointed payee, SSA must make periodic contacts to assure that the beneficiary's interests are being served.[337] In addition, when a beneficiary determined to be incapable is paid directly because no payee is available, SSA must contact the beneficiary periodically.[338]

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[334] See form SSA-11BK.

[335] POMS §GN 00502.150 (1989).

[336] POMS §GN 00502.180,A,2 (1989).

[337] POMS §GN 00502.180, A,3 (1989).

### 3. The Lack of Requirements And Verifications

While SSA has established certain procedures in the POMS for gathering information about payees prior to appointment, the agency does not regard the POMS as having the force and effect of law as would regulations, and leaves the kind and amount of information to be requested largely to the claims representative's discretion. In addition, prior to the 1990 amendments taking effect, claims representatives are not instructed to verify information provided by applicants, even though SSA's practice of asking the proposed payee whether he or she has ever been convicted of a felony is plainly an unreliable means of determining prior criminal records. Similarly, few procedures are in place which require SSA to verify other information provided by proposed payees. A northern California legal services attorney testified before Congress that:

> Our clients, out of desperation, have brought known alcoholics living on the streets into a Social Security office and had .those persons approved as payees on the spot, without even the semblance of an investigation. Social service personnel report to us that Social Security personnel will approve anyone who walks in the door as a payee with no questions asked.[339]

In March 1989, a federal court found that SSA personnel gravely neglected their 1984 statutory obligation to investigate payees before appointing them. The federal district court in Colorado, in *Holt v. Bowen*, ordered SSA to repay a disabled beneficiary more than $7,000 in benefits that had been misused by his representative.[340] The court stated that it was appropriate to defer to the "Secretary's authority to determine the scope of the investigation of proposed representative payees." Nevertheless, the court held that a proper investigation was a necessary condition to a valid certification for representative payment under the statute and at a minimum must include, "appropriate background questions along with a face-to-face interview."[341] These requirements have now been made statutory.

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[338] POMS §GN 00502.180,A,3 (1989).

[339] The Social Security Representative Payee Process, 1989: Testimony of Curtis L. Child, before the Sen. Comm. on Aging, p. 5, June 1, 1989.

[340] *Holt v. Bowen*, 712 F. Supp. 813 (D. Colo. 198

The 1990 law requires SSA to obtain documented proof of certain information, including the applicant's social security number, address, convictions for social security fraud, and termination or suspension of payee responsibilities in the past.[342] The 1990 law also requires SSA to establish a computerized information system that will make accessible such data on payees by their social security number. SSA must also conduct a study concerning the appointment of persons with criminal convictions as payees.[343] It is discussing with the FBI the feasibility of obtaining arrest and conviction records of persons who apply to become payees. These steps should be valuable in carrying out the Congressional intention that vulnerable beneficiaries be protected from exploitation by unscrupulous persons.

## 4. The Right to Contest Selection Determinations

In keeping with the relative weight accorded beneficiaries and proposed payees in SSA's selection determinations, beneficiaries are provided a right to contest the selection of a particular payee, while persons proposing to be appointed payees are not. Thus, a beneficiary is accorded the right to protest, seek reconsideration and appeal selection determinations in the same manner as determinations of the need for a payee.[344] These notice and hearing rights have passed constitutional muster in at least one federal district court. In *Fulk v. Moritz*, the court agreed with the court in *Tidwell v. Weinberger* that the notice and postdetermination procedural safeguards comported with due process requirements.[345]

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[341] The *Holt* court went on to find that SSA had been negligent in its failure to investigate the payee, who had an extensive criminal record, after it found that he had provided a false address and job references. In that case, the payee's prior criminal record for check fraud and robbery was easily accessible from local law enforcement agencies, yet the agency did not ask the applicant about his criminal record and made no attempt to determine it independently. The court held that SSA was under an obligation to investigate a representative payee before retroactive, lump sum benefits were released. *Id.* at 12. Although the statute provides that investigations may be made within 45 days after an appointment, the court noted that the conference report on the 1984 amendments directed the Secretary to establish procedures under which large lump sum payments of retroactive benefits will not ordinarily be paid to new representative payees until the investigation of their suitability has been successfully completed. Social Security Disability Benefits Reform Act of 1984, Conf. Rep. to accompany H.R. 3755, Rep. No. 98-1039 at 43 (Sept. 19, 1984). SSA's current guidelines would seem to require contact and some investigation of a payee's suitability prior to the payment of lump sum benefits, at least if payment is preceded by a period of suspended or delayed payment. POMS §GN 00504.130 (1986).

[342] OBRA 1990 §(a)(2)(i) and (ii), to be codified at 42 USC §405(j)(2)(B); 42 USC 1383 (a)(2)(B).

[343] OBRA 1990 §(a)(1)(B)

[344] 20 CFR §404.902(o), and (p) (1990).

However, a determination denying a request to be made a representative payee is not considered by SSA to be an initial determination entitling the applicant to seek reconsideration and appeal.[346] Nor have the courts required such procedural rights. In an analogous situation, it has been held that a wife certified as representative payee for her husband's veterans benefits did not have a due process right to be informed of a change in payee or a hearing on the question. Citing *Board of Regents v. Roth*, the court in *Sena v. Roudebush* held that the wife's expectation of continued receipt of her husband's benefits used for her support was not a property interest protected by due process. The wife conceded that she had no protectable interest in her status as representative payee for the benefits used for her husband's support.[347] The *Sena* court also interpreted *McGrath v. Weinberger* as holding that the interest in controlling benefits is not an interest protected by due process. The *McGrath* decision can also be read to hold only that the protected interest does not require predetermination notice and an evidentiary hearing for protection.[348] A more important distinction would seem to be the difference between the beneficiaries' interests in controlling benefits and the interest of applicants in expending funds for the benefit of others. It is unlikely that the interest of the latter would be found protected by due process under the test used by the Supreme Court in its most recent decisions. Thus, SSA regulations and guidelines, which do not afford applicant payees an opportunity to be heard either before or after a determination that they will not be appointed payee, would not seem to violate either constitutional or statutory requirements. The payee's interest in representative payment is not a personal interest in his or her own liberty or property, but is derivative of the state's interest in providing needed assistance to members of the public. Nor has this study discovered evidence that the lack of rights to administrative and judicial review prejudice significant interests of payees in initial or continued certifications.

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[345] No. C74-230 (N.D. Ohio, September 28, 1981).

[346] 20 CFR §404.903(c)(1990); POMS section GN 00502.003,B3,e (1989). A rejected payee, such as a legal guardian, who has appeal rights as the representative of the beneficiary, may appeal the selection of the payee, but not his/her own nonselection. *Id.*

[347] 442 F. Supp. 153 (D. N.M. 1977).

[348] See discussion note 257 supra.

## C. Suspension Of Benefits In Absence of Payee

The Social Security Act was recently amended to authorize SSA to suspend or withhold benefits for 30 days when entitlement has been found, the beneficiary has been determined to need a representative payee, and no payee can be found, if the beneficiary would be substantially harmed by direct payment.[349] Even before this Congressional authorization, it was SSA's practice to suspend benefits altogether for up to 90 days (and sometimes longer) in such circumstances.[350] No reliable data has been found indicating in what circumstances suspensions occurred, how often they occurred, how long they lasted, or what their consequences were.[351] Under the 1990 Act, direct payment may be suspended for more than 30 days, or until a new payee could found, in the case of legally incompetent beneficiaries, minors or SSI beneficiaries who were drug addicts or alcoholics.[352] However it is not clear whether the Act requires SSA to make a finding that direct payment would substantially harm these recipients before suspending their benefits. In an attempt to clarify its policy on suspension of benefits pending certification of a suitable payee, SSA issued a bulletin in March 1989 indicating that suspension is not mandatory and stating that claims representatives should "always consider direct payment whenever you cannot immediately locate a payee."[353]

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[349] *Briggs v. Sullivan*, 886 F.2d 1132, 1144 (9th Cir. 1989).

[350] POMS §§00504.100, 00504.200 and 00504.205 (1986). Section 00504.100 provides: Ordinarily, benefits will not be deferred or suspended more than 90 days pending payee development. If a temporary or permanent payee cannot be found within 90 days from the date the award is certified, or in postentitlement cases, 90 days from the date benefits are suspended, direct payment will be made unless:

1. The beneficiary is legally incompetent; or
2. The beneficiary is under age 15; or
3. For SSI benefits, the recipient is a drug addict and/or alcoholic (DA/A).

In these three instances, benefits will be withheld until a representative payee can be appointed. In all other cases, direct payment will be made after 90 days while payee development continues. Direct payment will be made before the 90-day period has expired if ALL possibilities of finding a qualified payee have been exhausted and ALL efforts are fully documented. This policy is not a substitute for complete payee development (see C below). Follow-up efforts to find a payee must continue.

[351] The 90-day limitation on such suspensions resulted from the settlement of a lawsuit brought to test the validity of SSA's suspension policy and approved by the federal district court in *Langson v. Regan* in 1982. *Langson v. Regan*, No 76C, 1668 (N.D. Ill. June 8, 1982).

[352] OBRA 1990 §(a)(2) to be codified as 42 U.S.C. §405(j)(2)(D) and §1383(a)(2)(B)(vii) (19__). See also, POMS §GN 00504.100 (1989).

[353] POMS Bulletin, "Representative Payee Policy Reminder,"IT-17.t13, file code CL-22-2 (March 31, 1989).

However, the POMS does not clarify the kinds of circumstances where it would be advisable to suspend benefits. This matter was left solely to the claims representative's discretion. With regard to Title II beneficiaries and Title XVI beneficiaries other than disabled drug addicts and alcoholics, the 1990 amendments require that SSA make a finding that direct payment would substantially harm the beneficiary.

SSA does not afford beneficiaries either notice of a proposed suspension of benefits or an opportunity to be heard before payments are withheld because of the absence of a payee. Beneficiaries are sent a notice by SSA informing them that, "we have suspended your benefits because we have not been able to locate any person or organization who is willing and suitable to receive and apply these benefits for your use."[354] The beneficiary can then request direct payment no later than 60 days from the receipt of the notice. Any protest of a suspension of benefits is treated as a request for reconsideration of that determination.[355] Thus, unlike determinations of the need for a payee, the determination to suspend benefits is implemented before the beneficiary is notified of the determination. Although the suspension of benefits was itself considered to be an initial determination by SSA subject to the formal appeals process,[356] it is unlikely that a full appeal could be prosecuted within the 30-day period during which payments may be suspended.[357] The deprivation of the use of entitlements by the agency without any notice or opportunity to be heard raises due process issues even more serious than those raised by the determination of incapability without notice or an opportunity to be heard. In the latter case, the beneficiary is afforded an opportunity to protest the determination before it is implemented. In the case of the suspension of benefits, the benefits are suspended before the beneficiary is given notice or provided an opportunity to protest.

The practice of suspending benefits pending identification of a suitable payee was successfully challenged in a class action law suit brought in Sacramento, California in 1988. In *Briggs v. Sullivan*, the plaintiff class was composed of Title II and Title XVI beneficiaries determined incapable of handling their benefits, who were unable to find representatives satisfactory to SSA or whose representatives were no longer able to serve and whose benefits had been suspended by the Secretary.[358] They sued to enjoin the Secretary from refusing to pay their benefits while a suitable payee was found and for compensation for the benefits withheld, maintaining that the suspension of benefits violated various provisions of the Social Security Act and the due process clause of the Fifth Amendment. Noting that both the Title II and Title XVI beneficiaries had been determined entitled to benefits and failed to receive them only because the Secretary or Congress had determined them incapable of handling their funds, the Ninth Circuit Court of Appeals described the devastating effects of SSA's withholding their benefits as follows:

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[354] POMS §GN 00504.220, E,1 (1986).

[355] POMS §GN 00504.225 (1986).

[356] POMS §GN 00504.220 (1986).

[357] POMS §GN 00502.003, B,1,d (1989). In describing the four phases of the administrative review procedures available to contest a suspension of benefits--protest, reconsideration, ALJ hearing and appeal to the Appeals Council--the court in the *Briggs* case noted that, "by its conclusion, the claimant will no doubt have developed an abiding, personal understanding of the phrase `administrative exhaustion'".

> The record before us, as the one before the district court, includes an extensive collection of affidavits from the appellants themselves, from individuals who operate soup kitchens and homeless shelters, from employees of social service agencies and church groups who seek to assist would-be benefits claimants, and from a dozen employees of Social Security field offices. These affidavits etch a grim image of homelessness and hunger. Rent cannot be paid, and mentally disturbed individuals take up "life" on the streets. Food and other necessities are foregone, causing the precipitous declines in physical and mental health which one might expect.
>
> [When determined incapable and then asked by SSA to find a payee or wait for SSA to find one] many such individuals turn to potentially unreliable characters--the fellow residents of homeless shelters, the most casual acquaintances, or the bartenders who provide alcohol abusers with their daily rations--to serve as their "trustees."
>
> The record reveals what, altogether too frequently happens next. The new representatives abscond with the beneficiaries' money or charge them "fees" of up to half of each check. Others, according to the affidavits filed below, will turn over funds only in exchange for sexual services. In some cases, the new representatives are soon judged unfit to serve as payees and payments are withheld once again.[359]

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[358] *Briggs v. Sullivan*, 886 F.2d 1132 (9th Cir. 1989). Plaintiff's benefits in this case were alleged to have been suspended for more than 90 days.

[359] *Id.* at 136.

The court of appeals found that temporarily paying beneficiaries found to be incapable of managing benefits could not breed circumstances worse than those created by the Secretary suspending the payment of their benefits altogether. In reversing the district court's denial of an injunction, the appeals court found that the plaintiffs had demonstrated probable success on the merits of their claim that suspension of benefits was not authorized by the statute or the regulations. The court did not rule on the plaintiffs' constitutional claim. Although the court recognized the agency had discretion to determine whether representative payment was in the interest of beneficiaries, it found that the agency had no discretion to suspend payments. Unlike the district court, which regarded the legislative intent supporting the Secretary's authority to be a desire to see that public funds were spent wisely, the court of appeals found that the legislative intent behind the Secretary's authority was not grounded in general notions of fiscal responsibility. Rather the appellate court found the legislative intent to be the desire to ensure that a beneficiary's money is spent for his or her own benefit. The court issued a temporary injunction restraining the Secretary from withholding payments to claimants who were temporarily or initially without representatives (other than Title XVI beneficiaries with drug and alcohol relation disabilities and legally incompetent individuals) and requiring him to pay such claimants directly until a suitable payee is found. The court also enjoined the Secretary from making representative payments to any person whom the Secretary had not investigated in accordance with his regulations and the POMS procedures. SSA agreed to apply the terms of the court of appeals decision in the Ninth Circuit but not elsewhere in the country.

By authorizing but limiting the Secretary's authority to suspend benefits when an appropriate payee is not available, Congress would seem to be rejecting SSA's past practice and the coersive concept of benevolence on which it was based. The fact that this was necessary indicates that the agency cannot be expected to make policy decisions balancing self-determination and benevolence without some substantive guidance from the Congress. There is still no legal authority supporting the constitutionality of the statutory authority to suspend entitlements without notice and hearing even for 30 days, or indefinitely in the case of Title XVI disabled drug and alcohol addicts and persons adjudicated legally incompetent.

## D. SSA's Responsibility To Find Payees

The final portion of the *Briggs* decision dealt with the claim of Title XVI drug and alcohol related disability beneficiaries that they were entitled to a payee provided by SSA. The court found that by virtue of certain POMS sections, there existed a self-imposed obligation on the Secretary to find payees for such claimants.[360] However, it did not find that the record supported a claim that the Secretary had not used reasonable efforts to do so in that case.

The lack of available payees for incapable social security beneficiaries is a real and serious problem. As the statistics suggest, there is an increasing number of persons determined to be incapable of handling their funds who have no friends or relatives willing to serve in their behalf. Deinstitutionalized persons, the older aged, and drug and alcohol abusers are among them. Unlike wealthier incompetents whose guardians receive a fee usually based upon the size of the estate they administer, the representative payee of a social security beneficiary is precluded by the agency from charging any fee for payee services. Payees are permitted to be reimbursed for reasonable actual out-of-pocket expenses incurred on behalf of the beneficiary, such as food, shelter, medical items, clothing, transportation and personal needs items. All other reimbursement for out-of-pocket expenditures must be approved by SSA.[361] The POMS guidelines suggest that claims representatives look to nonprofit organizations and public social service agencies when payees of higher preferential rank are not available. SSA will appoint as payee a public or nonprofit agency with actual custody, a private, licensed, for-profit institution with custody or other qualified and willing persons, such as members of community groups or organizations who volunteer to serve as payee for a beneficiary.[362] As set out in Appendix II, there are several kinds of public and private organizations that SSA may use to provide payee services to beneficiaries when they are available.

While these sources of public and private payees can be developed nationally and locally with the assistance of SSA, the question remains whether the agency is legally obligated to find a payee for beneficiaries who it has determined are in need of representative payment. That is, the finding of a need for representative payment is discretionary, but that once discretion has been exercised, the Secretary is obligated to certify payment to a representative. Since the statute does not authorize the nonpayment of benefits for longer than 30 days, to discharge its payment obligation, SSA would have to find a representative payee or itself serve as a payee of last resort for beneficiaries it has determined are in need of payee services. However, both alternatives are problematic. It may well be that there are situations in which there are no suitable and available payees for SSA to find, yet if SSA itself serves as payee, it is placed in a conflicted position as both the payor and the payee of benefits.

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[360] The court cites POMS provision GN 00502.020(B)(2) which calls for SSA to "develop" a payee immediately upon determining that direct payment cannot be made because of a Title XVI beneficiary's alcohol or drug-related disability determination. However, "develop" is not used in the POMS to mean find, secure or obtain a payee but rather to notify the beneficiary of the need for a payee and to gather information indicating possible available payees.

[361] POMS §GN 00602.110 (1988).

[362] 20 CFR §404.2021 (1988); POMS §GN 00502.10 (1989).

In somewhat analogous situations, courts have found that the state must either provide services to persons who it has deprived of liberty in order benefit them or restore their liberty. Thus in *O'Connor v. Donaldson*, the Supreme Court held that the state could not, consistent with due process, involuntarily confine a nondangerous mentally ill patient when the patient received no medical treatment for his mental illness.[363] This case may be said to stand for the principle that where the state deprives citizens of their liberty for the purpose of benefiting them, due process requires the provision of the benefit or the restoration of liberty. Such a notion of affirmative obligations attaching to beneficent undertakings by the state is also consistent with traditional tort concepts of the duty of care imposed on those who undertake rescue efforts to perform the rescue in a reasonable, nonnegligent manner. In the context of the representative payee program, this "good samaritan" principle would hold that the federal government is under no constitutional or other obligation to protect beneficiaries who are incapable of handling their social security benefits (i.e., Congress need not have passed section 205(j)), but that having undertaken to do so, the government must either take reasonable steps to provide such protection or restore the beneficiary's authority to control his or her benefits. The district court in *Holt v. Bowen* recognized such an obligation when it stated:

> It is clear from the above legislation [section 205(j)] that Congress intended the Secretary to undertake a measure of responsibility in the selection of a responsible representative payee when it makes a decision that such a payee is necessary. Inherent in the determination of incompetency by the Secretary is the assumption of responsibility that a proper representative payee will be selected.[364]

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[363] *O'Connor v. Donaldson*, 422 U.S. 563 (1975). The Court left open the question whether the state may confine a nondangerous person for the purpose of treating his mental illness, if treatment is provided. Other cases hold that persons deprived of liberty by being taken into state custody must be provided affirmative benefits such as medical care, to which they would not otherwise be entitled. See e.g., *Estelle v. Gamble*, 429 U.S. 97, 106, 116-17(1975) (intentional indifference to serious medical needs of prisoners constitutes cruel and unusual punishment); *Youngberg v. Romeo*, 457 U.S. 307, 324 (1982)(mentally retarded inmates of state institution have a Fourteenth Amendment right to food, shelter, clothing, medical care and training to ensure safety and freedom from bodily restraint.) Both cases involved persons in the custody of the state and considered dangerous to themselves and others.

[364] *Holt v. Bowen*, Civ. Action No. 88-F-1457 (D. Colo. 1989)

While the court in *Holt* found no statutory authority to withhold payments when a payee could not be found, it did not find that SSA had an affirmative obligation in such situations to provide or act as payee.[365]

The contention that SSA has an obligation to find payees is weakest in the case of Title XVI beneficiaries whose disability was based on a finding of drug or alcohol addiction. Congress has forbidden direct payment to such beneficiaries but provided that "the Secretary shall provide for making payments of the benefit to any other person who is interested in or concerned with the welfare of such individual."[366] However, the 1990 amendments authorize the Secretary to suspend the payment of benefits to such persons "until such time as the selection of a representative payee is made" regardless of the 30-day limitation otherwise applicable. Thus, if, the beneficiary is unable to find a payee, SSA should take all reasonable steps to find one.[367] Current SSA guidelines do not contain specific procedures that field offices must take to find available payees, to maintain information about sources of available payees or to develop payee resources.[368] Without such a requirement, there is a risk that if SSA fails to locate an available, suitable payee for these Title XVI beneficiaries, the benefits to which they are entitled will be suspended--often depriving them of subsistence. The constituionality of such a depreviation without notice and hearing is discussed above.

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[365] The obligation to obtain, nominate and compensate guardians for indigent incompetent residents of a state institution was imposed on the state in In re Gamble as part of its obligation to provide maintenance and other essential services to institutionalized person. 394 A.2d 308 (N.H. 1978). The decision has been characterized by commentators as standing for the proposition that:

> [W]here the state is responsible for an adjudication of incompetence and identification of need for guardianship, then the state is also responsible for providing a guardian where a willing and responsible family member or friend, or capability through the ward's estate of compensating a private guardian, is not otherwise available.

W. Schmidt, K. Miller, W. Bell and B.New, Public Guardianship and the Elderly 49 (1982).

[366] 42 U.S.C. §1383(a)(2)(A) and 1382(e)(3)(A) (1988). As one federal district court judge observed:

> This class of alcoholics and drug addicts. . . is the one for which strict supervision is or may be productive in providing incentives, mandatory or other wise, to participate in the rehabilitative efforts envisioned by the statute and is the class for which a representative payee is mandatory. *Hodges v. Weinberger*, 429 F. Supp. 756, 760 (D. Md. 1977).

[367] The court in *Briggs v. Sullivan* found that the facts before it did not justify the granting of a preliminary injunction on the Secretary's obligation to find payees. No. 89-15515 (10th Cir. 1989).

[368] Interview with Sheila Brown, Branch Manager, Landover, Maryland, December 22, 1989.

# VII. Monitoring Payee Performance

## A. Payee Responsibilities

Much of the concern in Congress and elsewhere about the representative payee program has centered around the need to monitor the performance of payees. In one of the few studies of payee performance, SSA reported that in a random sample of 8000 payees other than parents or spouses with custody and institutions subject to on-site inspection, there was some problem with payee performance in almost 20 percent of the cases, although it found only 4.4 percent of the payees were not satisfactory.[369] The court in *Jordan v. Schweiker*, using the *Mathews v. Eldridge* cost benefit analysis, determined that due process required, at a minimum, annual accounting by all payees for the plaintiff class. The *Jordan* decision is subject to the criticism usually leveled at the *Mathews* test--essentially that the courts are institutionally unsuited to making the determinations it requires. Since SSA is not bound by the *Jordan* ruling with regard to the monitoring of payees for nonclass members, the agency should consider initiating negotiated rulemaking to craft a rule through a bargaining process among represesntatives of affected interests that would apply to payees appointed since 1980.

In order to monitor the performance of payees, it must be clear what their responsibilities are and what techniques are effective in determining whether those responsibilities are met. In general, the payee's duties are those of a fiduciary or trustee. The representative payee is to use payments only for the best interests of the beneficiary, to notify SSA of any events that affect the beneficiary's entitlement to benefits, submit written accounting upon request, and notify SSA of changes that would affect the payee's ability to perform his or her responsibilities.[370] Providing the beneficiary with maintenance (food, shelter, clothing, medical care and personal needs), including the cost of maintenance in an institution, is a cardinal responsibility.[371] If the needs of the beneficiary are met, the payee may use excess benefits for the support of a legally dependent child, spouse or parent of the beneficiary.[372] The payee may pay debts of the beneficiary incurred before the certification of representative payment only if the funds are not needed to meet the maintenance needs of the beneficiary.[373] Any funds not needed for the support of the beneficiary or legal dependents must be conserved or invested in accordance with general rules applicable to trustees, preferably in government bonds or interest bearing accounts in insured banks or credit unions.[374] The payee is also responsible for enrolling the beneficiary in Part B of Medicare if appropriate.[375] SSA instructs payees in their obligations and requires them to sign a written acknowledgement of their responsibilities.[376] Although payees are not to expend beneficiary funds for their own benefit, in some family situations, a payee's financial eligibility for public benefits may be affected by receipt of benefits in representative payment.[377]

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[369] Social Security Administration; Representative Payee Study, Summary Report (1982). The 8,000 payees studied were randomly selected from 540,000, or 12 percent of all payees, who would have been subject to annual accounting prior to 1979. The study makes an effort to assess the payees' personal as well as fiscal performance and thus included evaluation criteria in addition to misuse of funds.

[370] 20 CFR §§404.2035, 416.635 (1990). SSA is bound to keep the payee informed of any action taken with regard to the beneficiary and to send the payee copies of any notice sent to the beneficiary. 3 OHA L. Rep. No.3, p. 10 (July 1979).

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[371] Thus, benefits accumulated by a payee were subject to recovery by a state hospital in payment for the cost of caring for the beneficiary for many years. *Department of Health and Rehabilitative Services v. Davis*, 616 F.2d 828 (5th Cir. 1980). Payment for maintenance charges in an institution is proper only when state law provides that the resident's estate is liable for his or her care and maintenance. Soc. Sec. Rul. 66-20, 68-18, 61-23. Payment of attorneys fees incurred in an effort to gain beneficiary's release from an institution is also proper. Soc. Sec. Rul. 66-42. The purchase of personal need items, such as decent clothing and personnel hygiene items, not provided by the institution have been held to be proper expenditures by the payee. Soc. Sec. Rul. 66-23.

[372] 20 CFR §§404.2050(c) and 416.640(c)(1990). Although at common law, adult children had no legal obligation to support their parents, some states have enacted laws which require adult children to support indigent parents. In those states, such parents are dependent and a payee may properly pay for their support after the beneficiary's needs have been met. Soc. Sec. Rul. 68-33,68-59, 68-50, 65-54.

[373] 20 CFR §§404.2050(d), 416.640(d) (1990).

[374] 20 CFR §§404.2045, 416.645 (1988). Any question as to whether a payee's investment in corporate stock is in accordance with general rules followed by trustees must be determined under applicable state law. Soc. SEc. Rule. 65-43.

[375] POMS §GN 00502.004,B,1 (1989).

[376] POMS §GN 00502.145 (1985).

[377] See *e.g.*, *Garvey v. Worcester Housing Authority*, 629 F2d 691 (10th Cir. 1980); *Smerick v. Commonwealth*, 407 A.2d 1378 (Pa. 1979); *Korbel v. Commonwealth*, 408 A.2d 910 (Pa. 1979).

## B. Payee Accounting--The Jordan Case Requirements

Until the ruling in *Jordan v. Schweiker*, SSA maintained that the obligation to supervise payees' performance of their obligations to beneficiaries was discretionary and not reviewable under the Administrative Procedure Act.[378] Prior to 1979, SSA had required payee accounting on a random sample basis, but discontinued the requirement in that year to reduce administrative costs. However, in 1983, the district court in the *Jordan* case held that due process required SSA to conduct mandatory, periodic accounting of all representative payments.[379] Because of the complex interaction of a number of appeals and motions filed by SSA in the district court, the *Jordan* ruling became an unappealable, final judgment without affirmance by the court of appeals, binding on the parties to the suit.

The *Jordan* suit was brought in 1979 by several social security beneficiaries who claimed to represent a class consisting of all social security beneficiaries receiving benefits under Titles II and XVI.[380] The class was certified in September, 1980. The plaintiffs presented three challenges to SSA's practices: they claimed first, that they were entitled to an oral hearing prior to the initial selection or continuation of a payee; second, that they were entitled to periodic mandatory accounting by their payees, and third; that they were entitled to full administrative and judicial review of claims of misuse by their payees under the due process clause of the fifth amendment and the Social Security Act.[381] The district court ruled that the plaintiffs were not entitled to preselection oral hearings or administrative and judicial review of misuse claims, but did find that the due process clause required "mandatory periodic accounting" by payees. Applying the *Mathews v. Eldridge* factors, the court found that the plaintiffs' interest in receipt and proper use of social security benefits was substantial, that the risk of erroneous deprivation of their interest through SSA's monitoring procedure was great, and that the probable value of mandatory accounting was substantial. The fiscal and administrative burden on the SSA, estimated to amount to a cost of $2.17 per beneficiary in representative payment, was found not to be too great.[382]

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[378] See *Watson v. Califano*, 487 F. Supp. 179, aff'd without op. 622 F2d 577 (2d Cir. 1979).

[379] *Jordan v. Schweiker*, Civ. 79-994-W (1983). The court noted that *Watson v. Califano* was dismissed on jurisdictional grounds and that no due process claim had been made in that case.

[380] *Jordan v. Schweiker*, Civ. 79-994-W, March 17 (1983). The names of the proceedings in the *Jordan* case can be confusing: The case was filed on September 7, 1979 under the caption *Jordan v. Schweiker*, Civ. 79-994-w. The district court's order of March 17, 1983 and March 26, 1984 were also issued in the case under that name. The district court's orders on July 2, 1984 was issued under the caption, *Jordan v. Heckler* (Civ. 79-994-w) as was the opinion of Tenth Circuit Court of Appeals, (744 F.2d 1397 (10th Cir. 1984)), and the district court's order on remand (January 18, 1985). SSA's second appeal, an appeal from the January 18, 1985 order, was decided by the Court of Appeals in *Jordan v. Bowen*, 808 F. 2d 733 (10th Cir. 1987).

[381] *Jordan v. Schweiker*, Order, p. 3-4, Civ.-79-994-W (W. D. Okl. March 17,1983).

The Secretary's appeal of this ruling was voluntarily dismissed. The plaintiffs appealed the district court's ruling on their entitlement to review of misuse findings, but did not pursue an appeal on their entitlement to preselection oral hearings.[383] The Tenth Circuit Court of Appeals affirmed the district court holding with regard to misuse hearings and review. In addition, it stated that in light of the fact that the "Secretary apparently has agreed" to require periodic accounting by payees, it would offer "no opinion as to whether accounting can be required under the Act or for due process reasons."[384]

About a year later, the plaintiffs filed a motion to enforce the judgment, objecting to SSA's proposed plan first, to notify all payees that they must keep records regarding their expenditure of benefits and that they might be required to account for such expenditures and second, to audit the accounts of a 10 percent random sample of payees. On March 26, 1984, the district court granted the plaintiffs' motion, finding that SSA's plan was inadequate and that plaintiffs' interests "can only be adequately protected by requiring universal annual accounting" by payees.[385] In addition, it held that "at this time" defendant's proposal to distribute and verify form 623 as an initial indicator of payee performance was adequate. It ordered SSA to "take immediate steps to provide all representative payees with SSA-623 forms and ensure the completion and return of those forms."[386] The Secretary appealed the order but the appeal was dismissed as premature because the Secretary had also filed a motion under Rule 59 in the district court, seeking modification of its March 26 order.

In its Rule 59 motion, SSA asked the district court to amend its order to permit the Secretary to exempt institutional payees from mandatory annual accounting on the understanding that SSA would conduct appropriate on-site reviews of these payees.[387] The district court granted that motion in July 1984.

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[382] The defendants claimed that SSA realized the $9.7 million cash value of the 489 work-years saved by eliminating accounting and verification. Dividing that sum by the 4,460,123 Title II and Title XVI beneficiaries who had representative payees, plaintiffs claimed the savings resulting from the elimination of accountings amounted to $2.17 per beneficiary in payee status.

[383] *Jordan v. Heckler*, 744 F.2d 1397, 1398 (10th Cir. 1984).

[384] *Id.* at 1399.

[385] *Jordan v. Schweiker*, Order, p.3, Civ-79-994-W (W. D. Okl. March 26, 1984).

[386] *Id.* at p.4.

[387] *Jordan v. Schweiker*, Civ.-79-994-W (March 26, 1983).

The Secretary then renewed its appeal of the March 26 order as amended and the court of appeals granted a stay.

In October 1984, subsequently passed legislation excluding payees who were spouses or parents with custody of the beneficiary from annual accounting requirements went into effect.[388] Believing that this legislation altered the situation in *Jordan*, the Secretary filed in the district court a motion seeking two things--first, an indicative ruling indicating how the district court would rule on a rule 60(b)(6) motion to amend its March 26 order on grounds that the new legislation justified granting such relief, and second, an order amending the March 26 order pursuant to Rule 60(b)(6). On the latter request,the district court held that it had no jurisdiction to amend its March 26 order because the Secretary's appeal from the order was before the court of appeals. However, it did find jurisdiction to decide the motion for an indicative ruling. Exercising that jurisdiction, the district court granted the motion for an indicative ruling, but indicated that it would deny a Rule 60(b)(6) motion on the ground that Congress had no authority to modify constitutionally required procedures and that "[T]he only way by which the Secretary can avoid the mandatory annual accounting is to establish that beneficiaries' due process rights are being adequately provided through some alternative means."[389] The court cautioned, however, that defendants should not read the order as an invitation to present further evidence on the two categories of beneficiaries excluded by the statute from accounting. These beneficiaries had the same rights as others, the court observed, and while the Secretary had had an opportunity to present evidence that beneficiaries' due process rights could be adequately provided through some other means, the Secretary had failed to do so. The district court concluded that it would not delay the termination of the case to allow the Secretary to submit such evidence. The Secretary did not appeal the district court's January, 1985 rulings.[390]

The appeal of the March 26 order as amended proceeded in the court of appeals and was ruled on on January 5, 1987. After reciting the history of the case, the court of appeals found that the Secretary had made no argument in his brief that the accounting from 10 percent of the payees meets due process requirements, and, thus he had waived his appeal of the March 26 order on that ground, and it dismissed the appeal. Further, it found that since no appeal had been taken of the January 1985 order, it need not rule on the Secretary's contention that the 1984 act of Congress was constitutional and provided the plaintiffs with due process of law. The Supreme Court refused to review the court of appeals decision.

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[388] P.L. 98-460, sec. 16(a); 42 U.S.C. section 405(j)(3)(B)(1989).

[389] *Jordan v. Schweiker*, Civ.-79-994-W, order, p. 6 (Jan. 18, 1985).

[390] *Jordan v. Bowen*, 808 F.2d 733, 737 (10th Cir. 1987).

SSA now requires annual accounting on Form 623 from all representative payees. The annual accounting Form 623, required of payees, requests relatively little information. It asks payees to report changes in the beneficiary's marital or custodial status, whether all the benefits were turned over to the beneficiary or a third party, whether there were any funds remaining, including accumulated funds, at the end of the reporting period, and if so where they were invested. It also asks whether the payee has ever been convicted of a felony. The representative payee is asked to check appropriate boxes, sign the form and return it to SSA. The forms are processed at the SSA process centers and any questions raised by the forms are referred to the payee's local office for followup.[391] Court-appointed guardians or conservators may file a copy of accounting reports required by the court in lieu of Form 623.

Pursuant to Congressional instructions, and with approval of the district court in the *Jordan* case, SSA has established a system of accountability monitoring for institutions in each state.[392] Most state mental institutions, mental retardation centers, mental health centers and public mental hospitals are monitored by SSA's on-site review program. They do not submit annual accounting forms for each beneficiary, but are visited every 3 years by review teams who interview staff and patients to determine the institution's payee performance. If the payee fails to comply with the accounting requirements within a reasonable time without good cause, payments to the payee may be terminated.[393]

Questions have been raised about the value of the present universal annual accounting procedure as a method of assuring the proper performance of payee responsibilities. On the one hand, SSA argues that the procedure is burdensome and unnecessary in the great majority of payee situations. Payees who intend to misuse benefits will provide false information on the forms which will be difficult to discover and prove false. Furthermore, misuse of beneficiary funds correlates with certain factors such as nonrelative, noncustodial status of the payee, and efforts to discover misuse would be better spent concentrated on such payees. On the other hand, some advocates for the elderly argue that the ineffectiveness of present procedures is due in part to the failure of SSA to verify and follow-up on information disclosed by the forms. More importantly, they argue that the annual accounting have a significant deterrent effect, much like the random audits conducted by the IRS, that would be lost if universal accounting were not required.[394] However, attorneys for the *Jordan* plaintiffs acknowledge that they have no interest in seeing ineffective accounting procedures maintained, and indicate that they would be interested in considering the effectiveness of alternative and perhaps less costly accounting procedures.[395]

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[391] Interview with Sheila Brown, SSA Branch Manager, Landover, Maryland, December 22, 1989.

[392] 42 U.S.C. §405(j)(3)(C)(1988).

[393] 20 CFR §§404.2050(f) and 416.650(f)(1990).

## C. Options for the Future

### 1. Postjudgment remedies in the Jordan case

Five years have passed since the district court last ruled that the Secretary must require universal annual accounting to protect the plaintiffs' due process interests. As discussed more fully in the attached memorandum, SSA may again seek an amendment to the March 26 order requiring universal annual accounting under Rule 60(b). Such a motion might be made either under subsection 5, on grounds that "it is no longer equitable that the judgment should have prospective application," or under subsection 6 for "any other reason justifying relief from the operation of the judgment." Alternatively, the Secretary may seek to have the judgment set aside or modified in an independent equitable action, where there is no available, adequate remedy at law. Such actions are usually permitted only where a motion under Rule 60(b) is not available.[396] While a Rule 60 motion for relief under subsection 5 must ordinarily be brought within 1 year, a motion under subsection 6 for relief "for any other reason" need not be.[397] The grounds for the latter motion must not be those that would support a motion under the other subsections of Rule 60 (mistake, inadvertence, excusable neglect, newly discovered evidence, fraud, etc.) and must contend that unforeseen and substantial changed circumstances, extreme hardship or extraordinary circumstances justify reconsideration of the order.[398]

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[394] Interview with Neil S. Dudovitz, Deputy Director, National Senior Citizens Law Center, Los Angeles, California, August 17, 1989. Dr. Dudovitz was lead attorney in *Jordan v. Schweiker, supra.*

[395] *Id.*

[396] 7 MOORE'S FEDERAL PRACTICE 60.38 [3] (1990).

[397] *United States v. Cirami*, 563 F.2d 26 (2d. Cir. 1977).

[398] See, e.g.,,, *id.*; *Ashford v. Steuart*, 657 F.2d 1053 ( Cir. 1981); *Duran v. Elrod*, 713 F.2d 292 (7th Cir. 19 ).

Thus, in the case of the *Jordan* order, since it has been much longer than 1 year since the operative date of the order, SSA must either file a motion for modification of the order under Rule 60(b)(6) upon a showing of extraordinary circumstances or bring an independent action on the ground that it has no adequate remedy at law, including under Rule 60(b). As discussed in the attached memorandum,[399] SSA could argue that circumstances have changed by virtue of its experience with universal annual accounting and that the experience shows that other methods of accounting will adequately protect the plaintiffs' due process rights, that universal annual accounting requirements subject SSA and payees to extreme hardship, or that the fact that Congress has determined spouses and parents with custody should not be required to account is a changed circumstance requiring reconsideration of the order. (SSA need not necessarily argue that the 1984 law has any legal affect on the March 1983 judgment.)

Alternatively, SSA could maintain that relief is not available under Rule 60(b) and bring an independent action to set aside the judgment. To support such an action, the agency must allege that the judgment ought not to be enforced in equity and good conscience; that it has a good defense to the action upon which the judgment was based; that fraud, accident, mistake or other justified circumstance prevented the defendant from benefiting from that defense; and that defendant is free of fault or neglect with regard to the judgment.[400] Although the Rule expressly does not limit the power of federal courts to entertain independent actions, in practice, the requirements for motions under Rule 60(b)(6) and independent actions are very similar.[401]

## 2. Rulemaking

Notwithstanding the *Jordan* order, SSA retains the authority to engage in informal rulemaking with regard to accounting requirements applicable to payees appointed for beneficiaries who are not members of the *Jordan* class. If it were to commence negotiated rulemaking, SSA might avoid some of the expenses and delays of traditional informal rulemaking and possibly establish a rule acceptable to both *Jordan* class members and beneficiaries who are not members of the class. The orders of the district court in *Jordan v. Schweiker* are binding only on parties to the action. If the description given by the court of appeals of the plaintiff class in *Jordan* is accurate, it consists of "all recipients of Social Security benefits (Title II) and Supplemental Security Income (Title XVI) who then [in September 1980] had a representative payee or had such a payee within six years prior to the filing of the action."[402] Thus, the Secretary is not bound by the terms of the *Jordan* order to require universal annual accounting by the payees of beneficiaries who did not have a representative payee in or prior to 1980. Such beneficiaries would include any Title II or Title XVI beneficiary who has had a representative payee appointed since September, 1980. Since many payees are appointed to handle the funds of elderly people and children, the payees to whom the *Jordan* order applies have dwindled significantly since 1980. With regard to nonclass beneficiaries, the Secretary would seem to be free to develop whatever accounting procedures he finds reasonable and effective. Although these actions might well be challenged in a new lawsuit, brought by beneficiaries who are not members of the *Jordan* class, the rulings of the district court in *Jordan* would have only weak precedential value in such a suit. The court of appeals did not affirm either the March 1983 or March 1984 orders--that is, it never ruled on the question of whether the due process clause of the fifth amendment requires universal annual accounting, or whether the 1984 congressional exceptions to universal accounting are constitutional. Therefore, in a suit by non*Jordan*-class members, the *Jordan* orders have only the precedential value of another district court.

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[399] Parness, Memorandum of Law on the Procedural Posture of "The Jordan Litigation, submitted to the Conference, July 1990.

[400] *Id.*

[401] *Shay v. Agricultural Stabilization and Conservation State Committee for Arizona*, 299 F.2d 516 (1962); *Nixon v. Brewer*, 49 F.R.D. 122 (D. Ala. 1970).

SSA procedural rules governing the representative payee program have been scrutinized by Congress as well as the courts. In both forums, some interested persons and organizations have maintained that the agency has failed to promulgate appropriate rules or that its rules do not meet constitutional and statutory standards. Yet, neither the Congress nor the courts may be well suited to gather or generate detailed information about the effect of the rules, nor to evaluate and weigh the interests of effected parties. Therefore, and for the reasons discussed below, SSA should consider whether negotiated rulemaking in an administrative forum is not a better institutional process for the development of procedural rules governing the representative payee program than either Congress or the courts or the agency alone.

## 3. Negotiated Rulemaking

### a. Background

Negotiated rulemaking is a process for permitting interested parties who will be affected by an agency rule to participate in the detailed formulation of the proposed rule before it is published in the Federal Register. The

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[402] *Jordan v. Bowen*, 808 F.2d 733, 734 (1987).

Conference of the United States has recommended that agencies consider using this procedure as a supplement to the informal rulemaking process called for by section 553 of the APA,[403] and Congress has recently enacted a bill to establish a framework for the conduct of negotiated rulemaking by federal agencies.[404]

Negotiated rulemaking is modeled in part on litigation settlements and the collective bargaining process and has been used to date primarily to develop rules regarding environmental issues. An agency considering negotiated rulemaking with regard to a set of issues would ordinarily select a neutral outside party (known as a convenor) to evaluate the feasibility of negotiating a rule, identify affected parties and organizations, design the structure of a negotiating committee, and propose a preliminary set of issues to be negotiated.[405] If the agency decides to proceed with this process, it should be willing to participate in the negotiations and should be committed to publishing a rule achieved by consensus in a notice of proposed rulemaking.[406] The goal of the committee's deliberations is to arrive at a consensus rule that all parties, including the agency can support or, at least, which no party will oppose. The agency may participate in the negotiations as a kind of disinterested referee protecting the public interest in negotiations between affected private interests, as in some environmental rulemaking proceedings. [407] Alternatively, the agency may actively participate as an interested party to ensure that the proposed rule is consistent with statutory requirements.[408] Because the agency is involved in reaching consensus, the parties can normally expect that the proposed rule will be put out for comment, and because most of the interested parties were involved, that the final rule might be very similar unless the agency receives unanticipated public comments or extraordinary circumstances arise.[409]

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[403] See generally, Testimony of Marshall L. Breger, Chairman, Administrative Conference of the United States on H.R. 3052 before the Subcommittee on Administrative Law and Governmental Relations of the House Committee on the Judiciary, August 10, 1988. See also Conference Recommendations 82-4, 85-5, "Procedures for Negotiating Proposed Regulations," 1 CFR §§305.82-4, 305.85-5 (1990).

[404] Negotiated Rulemaking Act of 1990, Pub. L. No. 101-648101st Cong. 2d Sess. Cong. Rec. H 1852 (May 1, 1990) to be codified as 5 U.S.C. 581 to 590. See also Negotiated Rulemaking Act of 1990, Report of the Committee on the Judiciary, H. Rep. No. 101-146, 101st Cong. 2d Sess. (1990). To date, most negotiated rulemaking has been initiated by agencies, without Congressional authorization or mandate. Among the agencies that have conducted negotiated rulemaking proceedings are the Environmental Protection Agency, the Federal Aviation Administration and the Occupational Safety and Health Administration. The EPA has used negotiated rulemaking to promulgate rules pertaining to vehicle emissions (50 Fed. Reg. 36,732 (1985) 40 CFR 66 (19 ) and pesticide exemptions (51 Fed. Reg. 1896 (1986); the FAA used negotiated rulemaking to develop flight and duty time regulations for airline flight crews (50 Fed. Reg. 29,306 (1985) 14 CFR 121,135); OSHA used negotiated rulemaking to develop a proposed standard for occupational exposure to benzene, but the negotiations did not produce a consensus and were abandoned (see United Steelworkers of America v. Rubber Mfrs. Ass'n. 783 F.2d 1117 (D.C. Cir. 1986) and has used negotiated rulemaking to develop a standard to protect farmworkers which similarly failed to produce a consensus rule (Perritt, 14 PEPPERDINE L. REV. 863, 896 (1987). For an evaluation of these efforts, see Susskind and McMahon, "The Theory and Practice of Negotiated Rulemaking," 3 YALE J. OF REG. 133 (1985).

[405] Typically, the agency identifies issues to be resolved through negotiated rulemaking, designates a "convenor" to identify affected parties and interests and evaluate the feasibility of negotiating the rules, and engages in face-to-face, round table discussions with representatives of such parties in order to reach a consensus about the substance of the rule. Often the agency has provided funds to the participating parties to finance research and hire staff to support their negotiation efforts and has agreed to publish as a proposed rule, the consensus rule formulated through negotiations. Conference Recommendation 82-4, para. 3. Conference, *Negotiated Rulemaking Sourcebook,* 97-105 (1990). Sometimes such a convenor has been a disinterested

Advocates of negotiated rulemaking maintain that the overall expense entailed in rulemaking, including subsequent litigation, can be reduced through the use of negotiated rulemaking and that "better" rules result. Interested parties can often avoid duplicative research and factfinding by cooperatively developing information necessary to the settlement of policy issues; there are fewer incentives for parties to develop excessive information to position themselves for subsequent litigation; positions are not polarized as they may be in regular, informal rulemaking proceedings; negotiation under a deadline produces consensus rules faster than informal notice-and-comment rulemaking; and parties involved in developing proposed rules are less likely to challenge

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person within the agency, and sometimes it has been a private organization with whom the agency contracts.

[406] If the convenor is successful in assembling a balanced committee, it may conduct prenegotiation training and orientation sessions, oversee the utilization of a resource pool provided by the agency to permit the parties to acquire necessary information and technical advice and to communicate with their constituents regarding their positions in the negotiations. See, e.g.,, Environmental Protection Agency Notice of Open Meeting of the Negotiated Rulemaking Advisory Committee on New Source Performance Standards for Residential Wood Combustion Units , 51 FED. REG. 18661 (May 21, 1986),51 FED. REG. 23468 (June 27, 1986) and organizational protocols, Conference *Negotiated Rulemaking Sourcebook*, 186-196 (1990).

[407] An agency may designate a section within the agency to coordinate negotiated rulemaking that has no responsibilities related to the substance of the rule being negotiated. Susskind and MacMahon, supra note at 160.

[408] The agency may act as a direct participant in the negotiations with a veto power over any consensus rule, a power inherent in its legislative authority to promulgate the final rule. Susskind and McMahon, "The Theory and Practice of Negotiated Rulemaking," 3 YALE J. ON REG. 133, 158 (1985).

[409] *Id.*

the rule after promulgation, thus reducing the likelihood of expensive litigation in the future. Furthermore, advocates of negotiated rulemaking contend that the process produces "better" rules in the sense that they are based on a process that not only takes empirical information made available through the process into account, and thus may be regarded as more accurate, but the process also takes policy positions of interested parties into account--something that agency dominated notice-and-comment rulemaking has not done well. The latter quality of negotiated rulemaking adds legitimacy to the resulting rule, based on notions of pluralistic, participatory government and respect for affected interests, as well as agency expertise.

### b. Conditions for Negotiated Rulemaking

The Conference and some commentators have posited several preconditions for successful negotiated rulemaking, many of which would seem to obtain in the case of the negotiating rules regarding the representative payee program.[410] First, interested parties must believe that they have more to gain from negotiating a consensus rule than from pursuing more adversarial alternatives, such as lobbying Congress or bringing lawsuits. This perception must be founded on a belief that the agency is committed to implementing the final agreements at least to the publication of the consensus rule in the FEDERAL REGISTER as a proposed rule. It also depends on a belief that the rule, if finally adopted, can be effectively enforced by the agency, even if challenged in court by those who did not participate in the negotiations. If SSA were to propose rulemaking around the question of payee accounting, groups interested in the *Jordan* case would have to believe that they have more to gain from cooperating with the agency and other interested parties in developing an acceptable, efficient, cost effective means of safeguarding beneficiary interests through rulemaking than through the enforcement of the existing *Jordan* order or through the challenge of a new agency rule governing accounting for nonclass members. SSA must be convinced that a consensus rule regarding representative payee procedures will be more administratively efficient in the long run, avoiding the time and expense of protracted informal rulemaking and post enactment litigation.

Second, it must be possible to choose a set of not more than 20 to 25 negotiators who can effectively represent various affected interests. No party or small group of parties should have so much power that they can dominate the negotiations.[411] In the case of representative payment, there are a number of organizations whose members will be affected by rules regarding payee accounting and other procedures governing the representative payee program. As in other contexts, there may be questions about the extent to which those organizations can represent their constituencies on the issues involved and the extent to which they can represent the universe of interests affected by the proposed rule.[412] In its report on the Negotiated Rulemaking Act of 1990, the House Judiciary Committee noted concern about the ability of organizations representing social security beneficiaries to adequately represent all affected interests, particularly poor people, in negotiations and suggested that special financial and education resources may be necessary in such situations.[413] While special resources may be necessary, this need alone ought not to disqualify poor people's organizations from participating in negotiated rulemaking where it is otherwise appropriate. Presumably, funding for negotiated rulemaking would be related to the need for it in each proceeding. In addition to the plaintiff class in the *Jordan* suit, organizations whose members are mentally or physically impaired may wish to participate in order to represent those constituents who receive social security benefits. Such organizations might include the Association for Retarded Citizens, the Mental Health Association of America and organizations of physically handicapped people. Organizations of social security beneficiaries, only some of whose members may be mentally or physically impaired, or likely to be so, may want to participate in representative payee rulemaking, as well. For example, the membership of the American Association of Retired Persons (AARP) is largely composed of persons entitled to social security retirement benefits. While most of its members do not receive their benefits through a representative payee, its members' interest in controlling and/or having assistance in managing their benefits is at issue in the rulemaking. As discussed in Appendix B, AARP has sponsored local projects providing representative payees for beneficiaries in need of them and would thus have valuable information and experience to bring to the negotiating table. Similarly, welfare rights organizations whose members are recipients of SSI benefits may be appropriate organizations to participate in negotiated rulemaking concerning payee issues. Organizations representing homeless people may be especially interested in the development of rules which serve the interests of this particularly vulnerable group. Alternatively, legal services agencies that have traditionally represented such interests may be appropriate organizations to participate in behalf of welfare beneficiaries who are eligible clients under the

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[410] Conference Recommendation 82-4, 1 CFR section 305.822-4(1988). Susskind and McMahon, "The Theory and Practice of Negotiated Rulemaking," 3 YALE J. ON REG. 133,138-139 (1985); Harter, "Negotiating Regulations: A Cure for Malaise," 71 GEO. L.J. 1, 42-51 (1981); 1 CFR 305.82-4 and 305.85-5 (1985). See e.g., Environmental Protection Agency's Regulatory Negotiation Project, 48 Fed. Reg. 7494 (Feb. 22, 1983).

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[411] Harter, supra note 410 at 46.

[412] Susskind and MacMahon, supra note 408 at n. 119.

[413] H. Rep. No. 101-146, 101st Cong. 2d Sess. 10 (1990).

Legal Services Corporation Act. Since almost all individual members of the public are potential social security beneficiaries, either as retirees, disabled persons or indigents, other groups whose members are only thus indirectly affected by payee rules may assert an interest in participating. Public and private organizations, such as state public guardians, Guardian Inc, and Community Advocates, that have provided payee services in the past might also be included. Other government agencies such as the Office on Aging and the VA could be invited to participate or consult in the negotiations to provide their expertise and perspective. The convenor would have to determine how many organizations with directly affected members were willing to participate and then determine which organizations with indirectly affected members to include, if any. If there are too many groups representing affected interests, the convenor may consider participation by coalitions of such groups.

Third, the subject of the rulemaking should involve several issues so that the parties can trade them off with each other in accordance to their preferential rankings.[414] In keeping with negotiation theory, it is important that the issues presented for resolution be framed in terms of shared objectives. If the situation is perceived as a zero sum game--one in which one party can win only at the expense of another party--a negotiated consensus will reflect only the relative strength of the parties bargaining positions.[415] Thus, weak parties will be able to exact little from the negotiations, while strong parties will gain at the expense of their opponents. On the other hand, if the situation is perceived as a market in which interested parties trade items that they value differently each gains through the exchange. For this kind of "integrative bargaining" to occur there must be a number of issues or subissues which the parties may trade according to their relative importance to the parties.[416] If, in

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[414] Lewicki and Litterer, *Negotiation* 75-129 (1985).

[415] This is sometimes referred to as "distributive bargaining." *Id*.

[416] As observed by Harter:

> The prime benefit of negotiations is that the parties affected by a decision can identify the issues involved, scale their respective importance, trade positions, and work out novel approaches in an effort to maximize their overall interests. Parties may yield on issues that have lower priority to improve their position on issues that have higher priority. This scenario, of course, assumes that their are multiple issues to trade. Negotiations are likely to be difficult when there is only one issue with a binary solution involved in the decision. In such a situation, because there will be a clear winner and a clear loser, there would be virtually nothing to negotiate. Thus, a regulation raising only a single issue, or even a very few issues, is an inappropriate candidate for negotiation. Very few regulations, however,

the case of payee rulemaking, the issue were framed as whether to require universal annual accounting, the situation might be seen as one in which SSA could win (by requiring less than universal annual accounting) only if the beneficiaries lose their right to such accounting announced in the *Jordan* case. However, payee rulemaking could be perceived as an effort to devise the most cost efficient, effective, fair and accurate means of protecting the interest of beneficiaries in the expenditure of benefits in their interest. So conceived, interested parties and the agency share fundamental values--protecting the interest of beneficiaries in the expenditure of their funds--and seek a common goal--the means of accounting that most efficiently and effectively furthers that interest. This issue breaks down into subissues or items about which the parties may differ, but which they may trade in an effort to construct a final rule that they regard as better than a rule produced by Congress, the agency acting alone or the courts. Thus, subissues which parties might consider include what kind of accounting should be required from what kind of payees, how often payees should account, what kind of verification and auditing should be done by SSA of what kinds of accounts, when new accounting rules should go into effect, etc. In addition, SSA might propose rulemaking with regard to related issues such as procedures and sanctions for payee misuse. Such topics would provide more than enough issues to permit parties to negotiate their differences through trades.

Fourth, the issues must be apparent to the parties and they must understand their importance and be ready to address them. There would seem to be little doubt that, at least with regard to the issue of payee accounting, some individuals and organizations who believe they are affected by representative payee policies are aware and understand the importance of the issue. Their participation in the legislative and judicial processes around the issue would indicate that they are ready to address it. Given the *Holt* and *Briggs* suits, the same can be said for other payee issues, such as the procedures for the selection of payees, handling claims of misuse, suspension of benefits, etc.

Fifth, there must be some basic agreement about the values at stake in the controversy. If the parties hold conflicting beliefs about fundamental values at issue in the rulemaking, they may have little success in resolving policy disputes.[417] In the case of procedures for determining the need for and monitoring the performance of representative payees, there would seem to be a large area of agreement between those who would require more and less process. For example, both the plaintiffs in the *Jordan* case and the SSA

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involve a single or only few issues. Most regulations raise a great number of issues suitable for discussion. Harter, supra note 410 at 50.

[417] Harter, 1,49; Susskind and McMahon, note 408 at 139.

would agree that the interests of beneficiaries in the expenditure of their funds for their benefit is the ultimate value to be pursued in this rulemaking. Furthermore, they would agree that the least expensive, effective means of protecting those interests should be chosen so that beneficiaries' interests can be enhanced in other ways. The means rather than the ends of the debated procedures is the issue to be resolved through rulemaking. The parties and the agency may evaluate differently the weight to be given to individual autonomy, dignity, social responsibility, efficiency, accuracy and fairness in devising appropriate representative payee procedures, but they would not seem to disagree that those are the values to be reconciled and maximized.

Finally, a deadline for rulemaking should be imposed to avoid parties using delay as a strategy for furthering their interests.[418] A deadline for rulemaking might be imposed by the agency when it announces that it intends to engage in negotiated rulemaking. In addition, SSA could consider unilaterally or jointly petitioning the *Jordan* court to amend the 1984 order by requiring the parties to engage in negotiated rulemaking, the result of which the court would consider in modifying its judgment. Courts have issued similar orders compelling the parties to negotiate remedial orders in class action lawsuits.[419] Such an order could establish a deadline for the negotiated rulemaking which then might produce an order applicable to both the plaintiff class in *Jordan* and nonclass members.

### c. Negotiated Rulemaking and Representative Payee Procedures

SSA could consider initiating negotiated rulemaking in several ways. First, it could simply announce its intention to commence negotiated rulemaking with regard to selected procedural issues pertaining to the representative payee program--annual accounting, misuse findings, needs determinations, etc., to be applied to all beneficiaries except those represented in the *Jordan* suit-- and seek a convenor to identify affected interest groups and determine the feasibility of negotiating these issues.[420] In addition, at the end of such rulemaking, SSA might seek to amend the *Jordan* order, as discussed above, to adopt the consensus rule. While the consensus rule produced by negotiated rulemaking would apply directly to only nonclass members, the *Jordan* plaintiffs might be invited to participate in the negotiated rulemaking so that they could jointly propose the resulting rule to the district court in the *Jordan* case.

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[418] Harter supra note 410 at 47.

[419] See e.g., *Dixon v. Weinberger* 405 F. Supp 974, 979-80 (D. D.E. 1976).

[420] Ruttinger, "Acquiring the Services of Neutrals for Alternative Means of Dispute Resolution and Negotiated Rulemaking," Background Report for Recommendation 86-8,1986 Conference 863 (1986).

Alternatively, SSA might move to amend the *Jordan* order seeking a court mandate the parties to engage in negotiated rulemaking, inviting other interested parties to participate voluntarily to a consensus rule for the court's consideration. In other class action lawsuits seeking injunctive relief to reform public programs and bureaucratic procedures, courts have required the parties to jointly propose detailed remedial orders for the carrying out of the courts general conclusions.[421] A court order requiring the parties to engage in negotiated rulemaking has the advantage that the process for the parties' negotiations has been established and refined. While the adoption by the *Jordan* court of a consensus rule produced through negotiated rulemaking would bind only the parties to the suit, it would provide for uniform treatment of class and nonclass members if the agency promulgates it as a final rule as well.

Negotiated rulemaking would have several advantages for the parties and some disadvantages. Negotiated rulemaking would present the *Jordan* plaintiffs with an opportunity to affect the outcome of a rulemaking process which will affect beneficiaries whose interests are similar or identical to those of the *Jordan* class members. There is reason to believe that representatives of the plaintiff class do not regard the present accounting process as the best possible means of protecting their clients interest in the proper expenditure of their social security benefits. They recognize that more efficient and effective accounting procedures might be developed. Therefore, they should not view the negotiating process as a situation in which some of the nonclass members can win only at the expense of class members.[422] Rather, negotiated rulemaking permits the plaintiffs an opportunity to indicate which of their client's interests--in personal dignity, individual autonomy, assistance in expending benefits, speedy determinations, accurate findings, etc.,--are more important to them. Courts using the *Mathews* factors to determine due process requirements have been criticized for failing or being unable to take all relevant interests into account.[423] In negotiated rulemaking, the plaintiffs and other affected groups evaluate their own interests and weigh the importance of their interests in trading off subissues involving universal accounting, annual accounting, retention of written records, payment for accounting and other payee services out of benefits, etc. As in the case of negotiations to settle litigation, this exchange model permits each party to enhance the satisfaction of its preferences through trade. The *Jordan* plaintiffs might well see this administrative forum as preferable to the judicial forum for engaging in the exchange and hammering out a detailed settlement with the agency. Another advantage of an administrative forum is that other interested groups would be involved who might share the plaintiffs' interests and threaten future litigation if their concerns are not taken into account by the agency.

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[421] *Dixon v. Weinberger*, supra note 419.

[422] Justice Black in his dissent in *Goldberg v. Kelly*, supra, saw a zero sum game played by disability beneficiaries and applicants, where the cost of retaining ineligible disability beneficiaries on welfare roles while due process is provided insures that "many [needy persons] will never get on the rolls, or at least that they will remain destitute during the lengthy proceedings followed to determine initial eligibility." 397 U.S.254, 279. It was also noted in *Goldberg* that most ineligible beneficiaries could not be made to repay benefits they received erroneously, and therefore, keeping such beneficiaries on the welfare roles until pretermination hearings were conducted increased the overall costs of the program. Moreover, it can be argued that since the resources available for the welfare program as a whole are limited, every dollar spent on due process procedures (the administrative costs of hearings) must be subtracted from the dollars that can be spent on benefits. The history of welfare funding since the *Goldberg* decision would not seem to support that argument.

SSA, too, may find negotiated rulemaking a preferable process by which to formulate rules pertaining to payee accounting and other procedural rules. SSA has been unsuccessful in the *Jordan* case in convincing the judge that procedures other than universal annual accounting can adequately protect the plaintiffs' interests. Furthermore, the district court indicated that it was not inviting SSA to submit further evidence about the efficacy of excluding spouses and parents with custody from accounting requirements. It may be that SSA could more effectively and convincingly present its experience and expertise in accounting procedures to cooperative interested parties in a more informal administrative setting than it can in the formal, adversarial climate of judicial proceedings on a motion to modify the *Jordan* judgment.

## D. Misuse of Funds

While SSA will investigate and make findings regarding misuse of funds by payees, its determination cannot be appealed by either the beneficiary or the payee. Beause the interests of both beneficiaries and payees in accurate misuse determinations is great and the number of determinations relatively small, *Mathews v. Eldridge* analysis, if not its consititutional import, suggests that SSA should develop procedures permitting unsatisfied parties to appeal such determination.

SSA makes a distinction between improper use of funds and misuse. Improper use of funds consists of expenditures which are well-intentioned but not in the best interests of the beneficiary, such as the payment of past debts while the beneficiary's needs go unmet. When SSA suspects improper expenditure of funds, it will contact the payee, discuss the situation and suggest better management.[424] Misuse of benefits occurs when a payee expends benefits for reasons other than the benefit of the beneficiary.[425] Misuse usually comes to the attention of SSA through complaints by the beneficiary, information from VA where the beneficiary is receiving dual benefits, the accounting reports, or evasive statements by the payee when in contact with SSA.

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[423] See e.g., Aleinikoff, "Constitutional Law in the Age of Balancing," 96 YALE L. J. 943, 977 (1987); Redish and Marshall, "Adjudicatory Independence and the Values of Procedural Due Process," 95 YALE L. J. 455 (1986).

Claims representatives are instructed by the POMS how to investigate misuse. The representative is instructed to contact the processing center about the accounting and custody verification forms to seek information about the payee's address or his or her associates. SSA will contact the payee and complainant personally, if possible, to establish the facts of misuse, and where this information is not conclusive, will contact the beneficiary's custodian, relatives, friends, school authorities and social service agency. The claims representative may also contact the beneficiary.[426] The determination of misuse is made by the claims representative and must include a statement of the rationale for the determination, the period involved, the amount of benefits misused and whether restitution efforts will be initiated, and the basis for this decision.

SSA regulations do not specify misuse determinations as initial determinations to which notice and appeal rights apply, and the POMS provides that a determination that benefits were misused cannot be appealed.[427] Thus, neither the beneficiary who is dissatisfied by a finding of no misuse nor a payee who is dissatisfied by a finding that there has been misuse may obtain administrative review of the Secretary's determination. The payee may dispute the finding of misuse if civil or criminal actions are brought by the agency or the beneficiary on the basis of a finding of misuse, but a payee does not have standing under the regulations to appeal the administrative finding itself or a termination of his certification or a change in payee. The beneficiary also is without administrative recourse. Section 205(k) provides that payment to a certified representative payee is a complete settlement and satisfaction of any claim, right or interest in and to such payment. Thus, beneficiaries who charge that their benefits have been misused by payees cannot appeal a determination by SSA that they have not been misused and that continued payment to the payee is appropriate. Although beneficiaries may be able to sue their payees to recover misused funds under state laws, they often do not have the resources or sophistication to do so. Thus, unless the Secretary makes a finding of misuse and seeks restitution from the payee, as discussed in the next section, the beneficiary is very often without an effective remedy.

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[424] POMS §GN 602.130 (1989).

[425] POMS §GN 00604.010, A (1989).

[426] POMS §GN 00604.020,B (1989).

[427] POMS §GN 00604.030 (1989).

In *Jordan v. Schweiker*, the plaintiffs unsuccessfully tried to obtain a declaration that due process entitled them to an appeal of an adverse misuse determination by the Secretary. They claimed that the agency's refusal to provide them administrative and judicial review of misuse determinations denied them due process. Using the *Mathews v. Eldridge* calculus, the *Jordan* court held that the value of administrative and judicial review of claims of misuse did not outweigh the fiscal and administrative burdens that their provision would entail.[428] Thus, beneficiaries still have no administrative recourse from determinations that their payees have not misused benefits.

If a finding misuse is made, the SSA will consider changing the payee, seeking restitution in civil proceedings and referring the case to the U.S. Attorney for criminal prosecution. The form 553 is sent to the processing center for retention and approval of the finding.[429] If the processing center approves, the claims authorizer will include an explanatory paragraph in the file indicating the amount of benefits misused, the basis for the misuse determination, and requesting restitution. The field office sends notification to the payee even if it does not intend to take any subsequent action to obtain restitution.[430] SSA may also continue payment to a payee who has misused benefits, if the payee makes or agrees to make restitution.[431]

## 1. Payee Responsibility for Misused Funds

SSA considers a representative payee who misuses benefits to be indebted to the beneficiary and obligated to make restitution.[432] SSA will seek voluntary restitution of misused funds by the payee and refer cases of misuse for criminal prosecution. SSA does not itself compel restitution of funds to the beneficiary. Nor will it, on its own initiative, obtain restitution of misused funds by withholding the benefits to which the representative payee is entitled in his or her own right. The agency regards such withholding as tantamount to an administrative attachment in conflict with section 207 of the Social Security Act.[433] To avoid prohibitions against attachment of benefits, SSA will withhold the amount of misused funds in installments from benefits due the payee, only upon the payee's request after an explanation of his or her rights.

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[428] *Jordan v. Schweiker*, Civ. -79-994-W , Order, p. 19 (March 17,

[429] POMS §GN 00604.050 (1989).

[430] *Id.*

[431] POMS §GN 00604.060 (1989).

[432] POMS §GN 00604.080, A (1989)

[433] *Id.*

A payee may make voluntary restitution by paying the amount of misused benefits to SSA for recertification to a new payee, to the beneficiary if determined capable of managing the benefits, or to the beneficiary's estate. SSA regards itself as obligated to seek restitution of misused funds on behalf of the beneficiary, regardless of the disposition of money so recovered.[434] Thus, even if the payee is an institution which will apply restored funds to its own maintenance charges, SSA may demand restitution. Restitution efforts will be abandoned if the recovery reviewer in the regional office determines that the payee is unable to repay funds, continued recovery efforts cannot be justified, or the payee cannot be located or has died.[435]

Cases of misuse of Title XVI benefits are referred to the Office of Investigations, in the Office of the Inspector General of the regional offices of HHS, for consideration of any criminal prosecution based on section 208(e) and 1632(4) of the Social Security Act.[436] Because misuse involves the fraudulent negotiation of Treasury checks, cases in which criminal prosecutions may be brought are referred to the Treasury Department, Secret Service branch, and eventually to the U.S. Attorney. SSA's efforts to recover misused funds will be abandoned where criminal or civil suit is declined by the Office of the Inspector General or the U.S. Attorney or where prosecution of the payee is found not to be in the beneficiary's best interest, as where the misuse is by a parent or spouse.[437] A form 553 must document the efforts made to secure restitution, the reasons why those efforts were abandoned and why further recovery efforts would be unproductive.[438] In its 1989 Report to Congress, SSA indicated misuse was discovered and recovery efforts initiated in 489 cases in 1989; 629 former cases were abandoned because the payee had died, could not be found, had no resources or it was not in the beneficiary's interest. In 82 cases, misused funds were recovered, and 9 cases were referred to the U.S. Attorney for civil suit.[439] No data is available indicating how many of the nine cases were prosecuted.

State of guardianship laws generally provide for recovery of misused funds from guardians through liability insurance. The guardianship laws of all states require guardians with control over property and conservators to post bonds insuring their fidelity. This kind of liability insurance should also be available to SSA payees, but is seldom, if ever, purchased. SSA does not require it and its cost cannot be recovered from administered funds, since SSA rules preclude the use of benefits to pay such administrative costs. Presently, AARP volunteer payees are insured by AARP, and other private agencies providing payee services insure themselves.[440] If SSA were to reimburse beneficiaries for losses resulting from payee mismanagement and theft, it would, in effect, provide such insurance for all payees. SSA could seek to recover misued benefits from the payees as subrogee of the beneficiary's claim. If SSA were responsible for payee losses, it would have greater incentive to investigate and select payees carefully and to effectively monitor their performance. However, unlike other insurers, SSA is in a position to make a final and unappealable determination of loss (i.e. whether a payee has in fact misused funds). If it were to reimburse beneficiaries when misuse occurs, SSA would be in a conflicted position with regard to them, even if beneficiaries could appeal such misuse determinations. Nevertheless, as discussed below, the agency currently discharges similar functions since it has agreed to it assume misuse losses if the agency finds it has not discharged its investigatory and other monitoring responsibilities with "good acquittance."

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[434] *Id.*

[435] POMS §GN 604.110 (1989).

[436] POMS §GN 00604.040 (1989).

[437] Social Security Administration 1989 Annual Report to the Congress, p. 32, n.4

[438] (1989). POMS §GN 00604.110,B(1989).

[439] Social Security Administration, 1989 Annual Report to the Congress, 32 (1989).

## 2. SSA Responsibility for Payee Misuse

Beneficiaries whose funds are misused because of SSA's negligence may recover such funds from the agency. In *Holt v. Bowen*, plaintiffs sought to recover misused funds from the Secretary, where representative payment was made to a payee the Secretary had failed to investigate, contrary to his statutory obligation.[441] The plaintiff, a beneficiary of disability benefits, claimed that his representative payee absconded with lump sum benefits of over $7,000. Unable to recover from the payee, Mr. Holt sought recovery from the Secretary. The court found that SSA had breached its statutory obligation to investigate Mr. Holt's payee before his appointment. Citing the Secretary's own policy of repaying misused benefits when the agency failed to make payment with "good acquittance," the court also found statutory and regulatory authority for the reimbursement.[442] It held that the Secretary could not make a "correct payment" pursuant to the statute without first properly investigating the suitability of the payee. Thus, the Secretary could not claim the protections of section 205(k). The court did not find that the beneficiary had a due process right to recovery of the funds, but the court noted that "[i]nherent in the determination of incompetency by the Secretary is the assumption of responsibility that a proper representative payee will be selected." Thus, there was some recognition of affirmative obligations attached to the Secretary's exercise of the authority to declare the beneficiary incapable of handling his own benefits.

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[440] Interview with Wayne Moore, Legal Council for the Elderly, September 22, 1989. AARP volunteers are insured against dishonest and intentional loss and a small set aside is used to cover inadvertent loss or mistake. See Appendix II.

[441] *Holt v. Bowen*, 712 F.Supp.813 (D. Colo. 1989).

[442] *Id.* at . The court cited the Conference Report to the Social Security Benefits Reform Act of 1984 which directed the Secretary to establish procedures under which large lump sum payments of retroactive benefits would not be paid to new representative payees until after the investigation of their suitability had been completed.

The policy of good acquittance to which the court referred in *Holt* is contained in the POMS. It provides that the SSA is not liable for misused funds if the benefits were properly paid based upon the information available to the agency at the time payments were made. However, the policy cannot be invoked if the agency did not investigate in a timely fashion an allegation of misuse after receiving complaints, did not follow proper procedures in investigating and selecting the payee, or if it made payment to the misuser payee after attempting to timely suspend benefits, establish direct payment or appoint a successor payee.[443] The determination of good or bad acquittance is made by the regional office at the suggestion of the local SSA office. The *Holt* decision, then, does not depart significantly from the SSA's own admission of responsibility in the case of negligent investigation and appointment of payees.

Like SSA determinations of misuse, determinations of good acquittance (which thus absolve SSA of responsibility under the POMS to repay misused benefits) are not considered initial determinations by SSA and therefore cannot be appealed by the beneficiary. However, *Holt* recognizes a judicial mechanism for enforcing SSA's policy. The Secretary had contended that the federal district court lacked jurisdiction in the case because the plaintiffs had not exhausted their administrative remedies and failed to meet the jurisdictional requirements of section 205(g) of the statute. The court found that the agency's denial of any obligation to pay plaintiff the misused funds was itself a final determination appealable under the terms of the statute.[444] Thus, the *Holt* decision may create incentives for SSA to find, appoint, and monitor qualified payees. However, it may also create incentives for SSA not to find misuse of funds, especially in cases where SSA may have been lax in investigating and monitoring the payee. Since beneficiaries have no administrative or judicial remedy to review determinations of no misuse or "good acquittance," *Holt* may be a double edged sword for some beneficiaries.

Similar issues do not come up in the case of state guardianships because almost all states require guardians to post bonds insuring the proper performance of their duties. However, the cost of bonding is covered by the fees guardians are permitted to charge the estates they administer. In the case of social security benefits, the cost of posting a bond could significantly reduce the benefits available to meet other needs of the beneficiary. Like the payment of a fee for payee services, some observers believe that such expenses ought not to be paid out of meager social security benefit payments. Nevertheless, one inescapable cost of the money management services that payees provide is the cost of misfeasance. That cost can be allowed to lie where it falls--on the beneficiary-victim--or the risk of such losses can be spread through insurance covering either the payee's liability (third party insurance) or the beneficiary's loss (first party insurance). Under state guardianship schemes, the guardian purchases third party insurance through fidelity bonds. If the SSA provides such insurance by repaying misused funds to beneficiaries, it spreads the cost of such losses among all social security contributors.[445] Like other insurers, SSA would take steps to minimize the likelihood of losses which it will reimburse.

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[443] POMS §GN 604.070 (1989).

[444] 712 F. Supp. 813, 815.

## VIII. Conclusion

The representative payee programs administered by the Social Security Administration is an example of the exercise by the federal government of what have been traditionally regarded as state *parens patriae* powers. Historically, states have exercised their *parens patriae* powers to protect the property and well being of mentally and physically impaired people by appointing a guardian to act in their behalf.[446] Originally available only to wealthy people, in recent times, these protections have been provided to low income persons as well and have been offered in conjunction with the provision of essential maintenance and social services.[447] Thus,states have added public guardianship services, child and adult protective services, mental health care and case management services to their guardianship procedures, in order to provide meaningful protection to their most vulnerable citizens.

The appointment of a representative payee is not a payment but a service. The authority granted to the Secretary of Health and Human Services in sections 205(j) and 1631 is not the authority to condition the entitlement to benefits on certain factors. Rather, like *parens patriae* power, it is the authority to protect the interests of certain individuals in one kind of property--social security benefits--by depriving them of the right to control the expenditure of benefits and granting it to another for their own good, with or without consent. As such it can put private and public interests in conflict. While these beneficiary interests in autonomy and society's interest in benevolence may coincide when beneficiaries and government agree on what expenditures benefit them, in some circumstances they are in tension or actual conflict. The agency is granted broad discretion to choose between them, in designing its procedures and utilizing them in individual adjudications, but is given little guidance from Congress as to how they are to be weighed. Perhaps as a result, SSA has evolved a program characterized by ambivalence--it neither fully protects autonomy interests nor adequately assures the beneficial assistance of payees. Yet, SSA is a payment agency, expert in making entitlement determinations and efficient in making payments to beneficiaries. It is not a social service agency. Representative payment may be the only SSA program in which the agency is asked to provide a social service to the public.

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[445] In *Holt*, SSA was obligated to repay funds abused by a payee it negligently failed to investigate. Public policy arguments can be made that SSA should assume responsibility for all misused funds and succeed to the rights of beneficiaries against misusing payees, regardless of its own good acquittance.

[446] See discussion at note *supra*.

[447] See *e.g.*, *In re Gamble*, 394 A.2d 308 (N.H. 1978).

Much of the agency's difficulty in administering its representative payee authority, then, may be due to its ambivalence about the fundamental interests the program puts in tension and the institutional inappropriateness of the task it has been assigned. That is, SSA may be structurally ill-suited and bureaucratically ill-disposed to providing the procedural safeguards protecting individual rights and the social assistance necessary to ensure individual welfare that traditionally has been provided by state courts and public service agencies. The greater array of procedural safeguards afforded in state guardianship proceedings is reflective of a libertarian tradition which prefers *a priori* liberty and property interests to state benevolence. The greater array of services provided by the VA in its effort to find, investigate, counsel, supervise, and assist incompetent veterans results in a program that may be less protective of personal liberty interests but more protective of individual claims to needed assistance. This preference may stem, in part, from the fundamental mission of the VA--to repay persons who have served in our armed forces. No such mission supports the social security program. Individuals are entitled to insurance benefits because they have been earned through self-interested labor, and to assistance payments because they are needed for bare subsistence--not because they are the deserved desserts of service to the nation.

Congress would do well to carefully consider the need for and full implications of assuming responsibility for the exercise of *parens patriae* powers on the federal level. Strong arguments can be made that social security benefits have no distinctive character which requires their protection by a federal representative payee program rather than by state guardianship or protective services programs in place to protect other property interests of vulnerable people. If SSA were to refer vulnerable beneficiaries to state guardianship proceedings as the exclusive means of determining a beneficiary's competence to handle financial affairs, the agency would focus primarily on the functionary role in social security payment to which it is well suited. Since many states do not have adequate social services to assist individuals in need of financial management services, federal funding of state efforts to develop and monitor adequate social services should be considered as an alternative to SSA funding for that purpose.

If Congress chooses to continue representative payment as a federal social security program, then, a bureaucratic structure should be created within SSA that can perform both its adjudicatory functions and its social service functions more effectively. In designing that structure, consideration should be given to such policy questions as the allocation of risk of error in determinations of the need for or entitlement to a payee and the development of services to assure that incapable beneficiaries receive more individualized payee services and the protection they need. If SSA were to initiate state guardianship proceedings where possible, establish a standard of minimally adequate competence and provide additional procedures to safeguard individual interests in need determinations, the number of beneficiaries in representative payment, and hence SSA's oversight responsibilities, should diminish. Were that to occur, the agency should have greater resources to devote to monitoring and enforcing fiduciary obligations of payees.

Finally, the imposition of representative payment is at bottom a value judgment that the government and its chosen payees can better determine and effectuate the welfare of certain individuals than can the individuals themselves. The agency's value judgments in this regard lack legitimacy if they are not based on some justifications or rationale why they should prevail over others. Because Congress has provided it little guidance, the agency's judgments cannot gain legitimacy as the execution of popular will expressed through legislative directives. Nor, as now constituted, can its decisionmaking process be justified as the embodiment of necessary expertise. The overwhelming number of payee determinations are made by claims representatives and health care professionals whose expertise is in different disciplines and who in any event, could not be expert in choosing between conflicting values. This report suggests that the agency consider initiating negotiated rulemaking as a way of providing legitimacy to the standards and procedures it adopts to regulate representative payee certification. That legitimacy would rest not on its enactment of the social will or expertise but on the participation of affected interests. While negotiated rulemaking requires the agency to deal with difficult questions of interest representation, issue definition, resource equality and consensus, these issues would seem to be no more difficult than the policy and legitimacy issues it faces without such a mechanism.

## Report for Recommendation 91-4

# Innovation and Challenge: The First Year of the National Vaccine Injury Compensation Program

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This report was prepared for the consideration of the Administrative Conference of the United States. The views expressed are those of the author and do not necessarily reflect those of the members of the Conference or its committees except where formal recommendations of the Conference are cited.

# Executive Summary

The National Vaccine Injury Compensation Program (Program) is a federal "no-fault" system of providing compensation to persons with serious adverse reactions to vaccines to prevent seven diseases of childhood: diphtheria, tetanus, whooping cough, poliomyelitis, measles, mumps, and rubella. Enacted on November 14, 1986, as part of the National Childhood Vaccine Injury Act of 1986, it became effective October 1, 1988.

The Program is an experimental solution to the inadequacy of the tort system in compensating children who died or were permanently disabled after a state-required immunization. It is expected to attract prospective litigants away from litigation. By removing the threat of litigation against vaccine manufacturers, it is also expected to encourage continued domestic childhood vaccine production.

Congress recognized that the Program would offer a comparative advantage over litigation only if it could award compensation quickly, fairly, and efficiently. Thus, programmatic efficiency is of paramount importance to the Program's success. This report presents a preliminary descriptive analysis of the Program's first year and a half of operation. It is intended to provide background information, raise questions, and generate hypotheses that warrant testing to evaluate the Program's long-term effectiveness.

## Program Summary

Decisionmaking authority is vested in the United States Claims Court. A new office of special masters hears petitions for compensation and determines both eligibility and amounts of compensation. A Claims Court judge reviews the special master's recommendation and makes the final judgment in cases filed before January 19, 1990. Pursuant to a December 1989 amendment the special masters issue the final judgment in cases filed thereafter, subject to limited review by a Claims Court judge. Persons with covered vaccine-related injuries submit a petition for compensation to the Claims Court. The Secretary of Health and Human Services (HHS) is named as respondent to the petition. The vaccine manufacturer and whoever administered the vaccine are not involved as a party to the proceedings. Decisions on cases filed under the original rules must be made within 1 year. For cases filed under the new rules, the time is 240 days, with some extensions possible.

Compensation may be sought for anyone who has a vaccine-related injury or death, regardless of when it occurred. However, petitions for injuries or deaths that resulted from an immunization given before October 1, 1988 (retrospective cases), must be filed by October 1, 1990. This deadline was extended until January 31, 1991, by a November 1990 amendment to the statute. Moreover, to be eligible, such retrospective cases may not have received damages as a result of a judgment or settlement of a civil action for the same injury. Petitions for injuries or deaths from immunizations given on or after October 1, 1988 (prospective cases), must be filed within 2 to 4 years after the injury is manifested. No civil action for damages may be filed in prospective cases unless and until the petitioner has received a determination and elected to reject it in favor of proceeding with litigation. The Program is an alternative to litigation because petitioners may not obtain compensation from both the Program and litigation.

Compensation is awarded only if the petitioner died or was permanently injured as a result of one of the seven covered vaccines. Causation is presumed for conditions listed in the Vaccine Injury Table. Prospective cases are entitled to compensation for nonreimbursable medical and related expenses, lost earnings, pain and suffering, and, in the case of death, a fixed sum of $250,000. Awards are paid from a Trust funded by a surtax on covered vaccine sales. Retrospective cases are limited to expenses incurred after the final judgment and not more than a total of $30,000 for lost future earnings, pain and suffering, and attorneys' fees and costs. Awards in retrospective cases are paid out of funds specially authorized by Congress.

## Experience from October 1, 1988 to February 28, 1990

By the end of February 1990, 236 petitions for compensation had been filed, substantially less than predicted. More than 82 percent of these petitions cited pertussis (whooping cough) vaccine, alone or in combination with diphtheria and tetanus toxoid (DTP), as the cause of injury or death. By February 28, 1990, 87 cases had been finally disposed of. Final judgments were issued in 70 cases; 17 cases were voluntarily dismissed by the petitioner. Compensation totalling $32,495,151.17 was awarded in 62 (88.5 percent) of the 70 final judgments. The vast majority of these awards (51 out of 62 or 82 percent) were in cases involving pertussis or DTP vaccine. The amount of compensation awarded in all 22 individual cases of permanent injury ranged from $27,081 to $2,772,855. Virtually all of the awards were for future medical, rehabilitative, and custodial expenses for the care of children immunized before October 1, 1988. Compensation in the statutory amount of $250,000 was awarded in each of 41 cases of death.

As the deadline for filing retrospective petitions was about to expire, and after this study was completed, the Program received a disproportionately large number of petitions in retrospective cases. Congress extended the deadline for filing to January 31, 1991, and by that date, 4,034 petitions had been filed in retrospective cases, and 98 petitions had been filed in prospective cases.

## Programmatic Innovations

The Program provides "no-fault," cause-based compensation. Unlike general benefit programs, compensation is limited to injuries from a single source--seven vaccines generally required for children before they enter day care or school. Yet compensation is available regardless of whether anyone is at fault or might be legally liable for the injury or death. The major decisions affecting entitlement involve the cause of injury, the nature of the resulting disability, and the amount of compensation needed to provide care for a permanently disabled person.

To simplify making decisions about the cause of injury, the Act includes a list of compensable injuries in the Vaccine Injury Table. Although the Table was intended to eliminate most disputes over the cause of injury, the majority of cases claiming Table injuries have been contested. Part of this is the inevitable result of applying statutory definitions to individual medical conditions and events. It suggests the need for more detailed interpretations of conditions that qualify as Table injuries and the proof required to demonstrate their occurrence.

The Act created a hybrid programmatic structure for deciding petitions, akin to an administrative tribunal. While Congress may have envisioned a simple administrative benefit determination, the statutory decisionmaking process is more similar to litigation. This hybrid structure requires participants to play new roles that are not well-defined in the statute. Considerable dissonance between the roles that may have been expected of the special masters and the Program's office within HHS and their statutory duties nearly brought the Program to a halt in mid-1989 and clarification is warranted. In particular, the role of the Secretary of HHS and the HHS Program office to which his functions are delegated merits further delineation. The Secretary is designated as respondent in proceedings to determine eligibility, administers the trust fund and makes payment of compensation awarded by the Claims Court. Although the Secretary is not granted general rulemaking authority for the Program, he may amend or modify the compensable injuries listed in the Vaccine Injury Table. These functions sometimes make it difficult for the Program office to review petitions both as an independent medical review body and as guardian of federal funds.

The Program's most innovative structural contribution is the creation of a unit of special masters empowered to make final determinations and develop less-adversarial decisionmaking procedures. These include relaxed rules of practice, informal status conferences, conducting conferences and hearings by telephone conference call or in locations convenient for petitioners in order to save time and money. Such procedures are adaptable to other benefit programs and dispute resolution systems. Procedures alone, however, cannot be expected to eliminate difficult questions of fact. An example is the difficulty experienced in calculating the amounts of compensation to be awarded.

## Conclusion

This report describes the Program in its infancy. Aside from having undergone both statutory and administrative changes, the Program has dealt almost exclusively with retrospective cases. Its decisionmaking procedures should apply equally well to prospective cases. But, the Program's future acceptability, and consequently, its effectiveness, depends more on reducing the areas of potential dispute and clarifying the roles of participants. The fundamental question is whether this new, hybrid decisionmaking process can settle controversies over vaccine-related injuries that have stubborn roots. This report suggests that it has the potential to do so.

The Program's experience after the period covered by this report tends to confirm its conclusions. Almost everyone involved with the Program is satisfied with its current operation. However, the large influx of retrospective petitions in late 1990 and early 1991 poses two real, if temporary, problems. One is concern that the time required to decide these claims will exceed the limits established by the Act. The second is the possibility that the funds appropriated by Congress will be insufficient to pay awards permitted by the Act. In November 1990, Congress responded to the first concern by granting the special master the discretion to extend the time for deciding claims for up to 180 days. However, an additional extension is likely to be needed. The second problem is more fundamental. If funding adequate to finance approvable awards is not provided, the Program may cease to function for the excess claims. Petitioners seeking compensation would be relegated to tort litigation as though the Program had not existed. This would mark a return to the circumstances that gave rise to the Program in the first place.

The burden of this bunching of retrospective claims will dissipate over time, assuming adequate sources of compensation are identified. It need not affect the Program's effectiveness in prospective cases. However, if the Program is not able to provide compensation in appropriate retrospective cases, its appeal to those with prospective cases could be significantly diminished. Every effort should be made to ensure the continued operation of the Program. Its benefits appear clearer with the passage of time.

# Introduction

This report presents a preliminary descriptive analysis of the National Vaccine Injury Compensation Program ("Program") through the middle of 1990. Because the Program's success depends heavily on the effectiveness of the administrative process in carrying out congressional intent, this report focuses on the ways in which the programmatic structure laid out in the statute has been translated into administrative decisionmaking procedures. Chapter I presents some of the background leading to enactment of the Program and the goals it may achieve. The Program's statutory design and operation is summarized in Chapter II. Chapter III describes the special function played by the Vaccine Injury Table, which lists compensable injuries, and some of the difficulties experienced in its application. The decisionmaking process developed to suit the Program's hybrid programmatic structure is described in Chapter IV. Chapter V describes the special functions Program participants perform and the new roles they are assuming to do so. Chapter VI presents the results of decisionmaking during the Program's first 17 months. Chapter VII summarizes the Program's achievements as well as the difficulties it has faced and offers suggestions for evaluating the Program over the next few years. Recommendations follow Chapter VII.

Because the Program is new and the enabling legislation has been amended several times, the findings reported herein must be viewed with caution and as preliminary only. Any new program requires a break-in period to achieve workable procedures. This is particularly true in the case of this Program. Therefore, the conclusions reached with respect to experience during its first year and a half need not apply to its future operation. This report is intended to provide basic background information, raise questions, and generate hypotheses that warrant testing to evaluate the Program's future effectiveness.

After this report was submitted to the Administrative Conference, a large number of claims was filed with the Program. An epilogue is appended to the report, which summarizes the implications of this development for the Program.

# Chapter I. The National Vaccine Injury Compensation Program: Background and Goal

## Background

The National Vaccine Injury Compensation Program (Program) is a federal "no-fault" system of providing compensation to persons who have had serious adverse reactions to vaccines to prevent seven diseases of childhood: diphtheria, tetanus, whooping cough, poliomyelitis, measles, mumps, and rubella. The Program was enacted on November 14, 1986, as part of the National Childhood Vaccine Injury Act of 1986.[1]

The Program is experimental in the sense that it creates a new and almost unique system of benefits for injuries resulting from one source. It was believed to be a solution to the inadequacy of the existing tort system in compensating children who were severely disabled or who died after a required immunization against a childhood disease.[2]

The National Vaccine Injury Compensation Program is the result of almost 2 decades of debate over whether and how adverse reactions to childhood vaccinations should be compensated. The most fundamental controversy was and is over whether certain injuries suffered by children following an immunization were in fact caused by the vaccine that was administered. Many vaccines, like most pharmaceuticals, may cause side effects even when properly manufactured and administered. These may range from self-limiting soreness or fever to more severe reactions like anaphylaxis or even death.[3] The more serious side effects or adverse reactions are fortunately rare. Immunization has protected tens of thousands of children against serious infectious diseases that once claimed too many lives. Thus, in general, the risk of severe illness or death from an infectious disease in unimmunized children is far greater than the risk of an adverse reaction to immunization. It is for this reason that all states require children to be immunized against childhood diseases before they enter day care or school and come in regular contact with other children. If a sufficiently large proportion of the population is immunized, the disease will not spread significantly, and the entire population benefits.

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[1] 100 Stat. 3756, codified as Title XXI of the Public Health Service Act at 42 U.S.C. 300aa-1 et seq. (Supp. V 1987). The Compensation Program is codified as Subtitle 2 of Title XXI, 42 U.S.C. 300aa-10 to 300aa-34.

[2] House Rep. No. 99-908, House Comm. on Energy & Commerce, 99th Cong. 2d Sess., 1986 U.S. Code Cong. & Admin. News 6344, 6348 (Sept. 26, 1986) (hereafter "House Rep. 99-908").

[3] Institute of Medicine, VACCINE AND INNOVATION 69-80 (1985).

Nonetheless, serious adverse reactions are a tragedy for the individual children and families who suffer them. Unfortunately, they are often unpredictable, occurring in children for whom there is no known medical contraindication, such as immunosuppression, for immunization. Identifying an adverse reaction to a vaccine is sometimes difficult since some medical conditions, especially neurological abnormalities, tend to first appear about the same time that infants receive immunizations. In individual cases, there may be no way to determine whether the condition was an adverse reaction to a vaccine or happened coincidentally as the result of an unrelated cause.[4] The salient example of this difficulty is the pertussis vaccine, usually given in combination with diphtheria and tetanus toxoids (DTP). The pertussis vaccine has been the subject of longstanding controversy over whether or how often the vaccine causes encephalopathy, infantile spasms, or residual seizure disorder, which may lead to permanent physical disability and mental retardation.[5] Many parents of children who suffered such injuries after vaccination and some physicians and scientists believe strongly that pertussis was the cause of injury and that such adverse reactions occur more frequently than has been reported. Other physicians and epidemiologists believe equally strongly that injuries are more often than not merely temporally associated with vaccination and that some injuries cannot be attributed to pertussis vaccine at all.

This controversy over whether and when a vaccine caused a particular injury to an individual child has been played out in civil tort actions against manufacturers. Since the critical issue in such cases is whether the vaccine caused the injury, the dispute over causation extended from the scientific arena to the courtroom. Vaccine manufacturers felt besieged by claims for disabilities that they believed were not vaccine-related. Parents felt abandoned at the time they most needed help.[6] By the 1980s, litigation was proving to be an unsatisfactory means of resolving this kind of dispute.[7]

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[4] The cause of some adverse reactions, such as paralysis following immunization with oral poliovirus vaccine, may sometimes be determined by laboratory tests that distinguish a wild (disease) virus from that used in the vaccine.

[5] *See* Institute of Medicine, VACCINE AND INNOVATION 67-72 (1985).

At the same time, pediatricians and public health officials, particularly those in agencies of the Department of Health and Human Services, were becoming concerned about more than a decade of decline in the number of United States companies that produced childhood vaccines. They feared that if a manufacturer experienced any trouble in vaccine production or, worse yet, decided to stop producing vaccines, the country could be without enough vaccines to prevent a serious epidemic. They also worried that liability concerns might discourage manufacturers from continuing to supply vaccines.[8] Manufacturers raised their vaccine prices in the mid 1980s at least in part to cover anticipated liability expenses. But the price rise threatened both public immunization programs funded by the federal and state governments and private efforts to encourage immunization.

From the mid 1970s to the mid 1980s, several national groups studied this constellation of problems seeking a way to ensure a stable vaccine supply and affordable vaccine prices, and to provide assistance to persons with vaccine-related injuries.[9] While none recommended a definitive solution to all aspects of the problem, all proposed consideration of a system to compensate vaccine-related injuries. In 1984, the American Academy of Pediatrics took the initiative by seeking federal legislation to create such a compensation program. Several bills were introduced by members of Congress and debated vigorously in congressional hearings. Ultimately, the National Childhood Vaccine Injury Act of 1986 emerged under the sponsorship of Representative Waxman and Senator Hatch.

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[6] The cost of caring for severely disabled children was rarely covered by private or public insurance, such that the only source of financial assistance for many was compensation in damages from whomever might be legally liable for the injury. Although many states, like California, have programs to assist disabled children, it is not known how many parents were aware of the program or whether their benefits were adequate in these cases.

[7] "Much of the controversy in the United States over liability for vaccine-related injuries reflects a belief that the class of injuries deserving compensation is broader than the class of injuries for which manufacturers of vaccines should be held responsible." Mariner, *Compensation Programs for Vaccine-Related Injury Abroad: A Comparative Analysis*, 31 ST. LOUIS U.L.J. 599, 601-2 (1987). A civil action for damages against the vaccine manufacturer sometimes offered a source of compensation. However, a successful cause of action depended upon proving either negligence or a defect in the vaccine or inadequate warnings of vaccine risks. Most injuries caused by vaccines were the unpredictable result of inherent risks in a properly manufactured nondefective vaccine, for which no one would be liable in tort law. Even if a cause of action might seem plausible, the uncertainty and expense, coupled with the lack of success in the majority of reported cases, made litigation an unreliable source of compensation. Because all states required childhood immunizations for day care or school entry, with few exceptions, the option of refusing immunization was rarely available.

[8] *See* generally Institute of Medicine, VACCINE AND INNOVATION 85-122 (1985); MEDICINE IN THE PUBLIC INTEREST, IMPEDIMENTS TO VACCINE RESEARCH (1984); U.S. Dept. of Health Education and Welfare, *Reports and Recommendations of the National Immunization Work Groups* (1977); Mariner and Clark, *Confronting the Immunization Problem: Proposals for Compensation Reform*, 76 AMERICAN JOURNAL OF PUBLIC HEALTH 703 (1986), Kitch, *Vaccines and Product Liability: A Case of Contagious Litigation*, 1985, REGULATION II (May/June 1985).

Like all legislation, the Act was the product of compromise. As Representative Waxman has pointed out, no one was entirely happy with it. Some vaccine manufacturers were unhappy with the fact that the compensation system was not an exclusive remedy. They preferred greater, if not complete, protection against civil product liability actions. The largest organization of parents of children with vaccine-related injuries, Dissatisfied Parents Together (DPT), lent its support largely because the Act included provisions to develop better information about adverse reactions to vaccines and to further research to improve existing vaccines to reduce their inherent risks. While DPT had initially joined with the American Academy of Pediatrics in preparing legislation, it was concerned that the final Act's focus on compensation would deflect attention from the problem of improving vaccines themselves. Other parents' groups opposed the Act for that reason.

The Reagan administration opposed much of the Act for fear of setting a precedent for no-fault compensation for injuries from other causes. Senator (now, Vice President) Quayle conveyed the gist of the Administration's objections to the bill when it was in the Senate in October 1986:[10]

> There are some aspects of the bill about which the White House is very upset, in particular the National Childhood Vaccine Injury Act of 1986. They are concerned that this particular part of the legislation will be costly...that it may

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[9] U.S. Department of Health, Education, and Welfare. *Liability Arising Out of Immunization Programs: Final Report to Congress* (DHEW, 1978); U.S. Congress, Office of Technology Assessment. *Compensation for Vaccine-Related Injuries* (technical memorandum) (OTA, 1980); American Academy of Pediatrics. *Need for Legislation to Establish a Federal Compensation Program for Vaccine-Related Injuries in Childhood Immunization Programs* (March 11, 1983); American Medical Association. *Final Report of the ad hoc Commission on Vaccine Injury Compensation* (April 1984); American College of Physicians. *Compensation for Vaccine-Related Injuries* (July 26, 1984); American College of Physicians and American Academy of Pediatrics. Joint Resolution on Compensation for Vaccine-Related Injuries (November 4, 1985) (Approved by Council of Medical Specialty Societies, November 26, 1985.); Institute of Medicine. VACCINE AND INNOVATION (1985).

[10] 132 Cong. Rec. S 17344-45 (daily ed. Oct. 18, 1986).

> open the floodgates to similar other coverage of types of injuries under a no-fault system.

The Department of Justice also opposed creation of a no-fault compensation system. In testimony on a predecessor bill, S. 827, the DOJ noted that creation of an entitlement program was a major step and argued that it should not be undertaken "in the absence of compelling evidence that the existing method of compensating victims through the tort system is inadequate."[11] The DOJ also predicted that "a no-fault approach will not significantly simplify the process of determining which claimants should receive compensation."[12] Moreover, it argued that because there appear to be "only a handful of childhood vaccine-related injury cases every year, it may be far more cost effective to leave such cases in the tort system...."[13]

Many in the Department of Health and Human Services were concerned that a federal compensation system would undermine immunization programs by focusing public attention on adverse reactions to vaccines instead of the benefits of immunization. In 1984, the Assistant Secretary for Health and the Directors of the Division of Immunization of the Centers for Disease Control testified in opposition to an earlier bill (H.R. 5810) that would have created an almost identical compensation program. Dr. Brandt noted that although the bill had a "laudable goal," it was impossible to support because of "major weaknesses."[14] These included the amount of compensation, which the department believed to be too high, the inclusion of retrospective cases, and, most importantly for today's Program, the list of compensable vaccine injuries. They believed that causation was too tenuous in many cases to allow the "nearly automatic" compensation afforded by the bill.[15]

Nonetheless, the Act did offer something for almost everyone and passed Congress in late 1986. Despite the compromises, it was the first change in policy that attempted to address the problems of fairness to injured persons and protection of the federal immunization program.

Given its history, it is not surprising that the Act did not get underway immediately. The provisions pertaining to increased vaccine research (the National Vaccine Program) were not funded by appropriations until 1989, and these activities are not yet fully staffed. The compensation Program had no source of funding for more than a year after its enactment. Congress specified that the compensation Program be funded from revenues derived from a surtax on vaccine sales, and that the Program would not become effective until the tax was enacted. But the tax was not enacted until 1987. Tax revenues would not be available for awards payable in retrospective cases during the first year or two of the Program. Accordingly, provisions for funding compensation awards in retrospective cases, authorizing the appropriation of $80,000,000 for each of the first 4 years of the Program, were added in December 1987.[16] The Program was then set to become effective on October 1, 1988, almost 2 years after it was signed into law. Funding to create a separate unit of special masters to the United States Claims Court to hear claims was not made available until the end of September 1988, so the Program did not actually begin to consider petitions until February 1, 1989.

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[11] National Childhood Vaccine Injury Compensation Act of 1985: Hearing on S.827 Before the Senate Comm. on Labor & Human Resources, 99th Cong., 1st Sess. 228 (1985).

[12] *Id.* at 231.

[13] *Id.*

[14] Testimony of Edward Brandt, Assistant Secretary for Health, DHHS, before the House Subcomm. on Health and Environment on H.R. 5810, Sept. 10, 1984, at p. 60.

[15] *Id.* at 63-65.

## Goals

Members of Congress and diverse constituencies who supported the National Childhood Vaccine Injury Act envisioned it as a means to achieve one or more of at least seven possibly conflicting goals:

- To provide reasonable compensation;
- To persons who were severely injured as a result of a childhood immunization;
- To stabilize, and ideally reduce, the price of childhood vaccines;
- To ensure the continued production of childhood vaccines to supply the country's immunization programs;
- To maintain or restore public confidence in immunizations and to improve national childhood immunization rates;
- To provide the public with adequate accurate information on the benefits and risks of immunization;

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[16] National Vaccine Injury Amendments, Pub. L. No. 100-203, Title IV, Subtitle D, 101 Stat. 1330-221, December 22, 1987, codified at 42 U.S.C. 300aa-15(i), (j). An additional $80,000,000 for fiscal 1993 was added by later amendment.

- To encourage research to develop safer vaccines, both to replace existing vaccines and to prevent other diseases.

The compensation program was not necessarily expected to accomplish all these goals. A separate National Vaccine Program, which requires the Secretary of Health and Human Services (HHS) to coordinate federal vaccine research and immunization programs, was included in the Act to encourage more vaccine research.[17] Additional provisions in the Act are intended to collect and disseminate more and better information about vaccine use and adverse reactions to vaccines,[18] and to promote the development of vaccines that result in fewer and less serious adverse reactions.[19] An Advisory Commission on Childhood Vaccines appointed by the Secretary is to advise the Secretary on accomplishing these goals, as well as Program implementation.[20]

The compensation system created by the Program was most specifically intended to achieve the goal of fair compensation.[21] At the same time, most members of Congress hoped that it would also contribute to stabilizing vaccine supplies and prices and to improving immunization rates.[22] The basis for this hope was the assumption that potential liability was a disincentive to manufacturers to enter or stay in the vaccine business.[23] The Program was intended to remove that disincentive by serving as a substitute for litigation against vaccine manufacturers.[24]

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[17] Public Health Service Act, Title XXI, subtitle 1, 42 U.S.C. 300aa-1 to 300aa-6 (Supp. 1987). The National Vaccine Program was established "to achieve optimal prevention of human infectious diseases through immunization and to achieve optimal prevention against adverse reactions to vaccines." 42 U.S.C. 300aa-1. The National Vaccine Program did not receive funding until 1989. The Director of the Program is Assistant Secretary for Health, James O. Mason, M.D.

[18] Requirements for recording and reporting vaccinations with childhood vaccines and adverse reactions to vaccines are included at 42 U.S.C. 300aa-25. Vaccine manufacturers are required to maintain detailed records on each batch or lot of vaccine produced. 42 U.S.C. 300aa-27. The Secretary of HHS is also required to develop and disseminate vaccine information materials for use by parents of children being vaccinated against covered diseases. 42 U.S.C. 300aa-26. Although the materials were to have been distributed by December 22, 1988, they had not been completed as of June 1990.

[19] 42 U.S.C. 300aa-27.

[20] 42 U.S.C. 300aa-19.

[21] In introducing the legislation, the House Committee on Energy and Commerce explained its desire to help those few children who suffered adverse reactions in an immunization program that provided a valuable public benefit: "The Committee recognizes that because of many States' standards of proof of liability, many vaccine-injured persons are presently without legal remedy under current tort law. The Committee anticipates that many of these persons will be compensated for their injuries under the compensation system." House Rep. 99-908 at 6354 (Sept. 25, 1986).

[22] In the Report accompanying technical amendments to the Act in late 1989, House conferees restated the original goals of the Program as follows: "The system will provide compensation, eliminate the need for litigation and assure the continued availability of and public confidence in immunizations in the United States." Conference Report No. 101-386 to accompany H.R. 3299, Omnibus Budget Reconciliation Act (OBRA) of 1989, Title VI, Subt. D.,

To do so, the Program must meet the more specific objectives of assuring prompt awards of fair compensation that will attract potential claimants away from civil tort actions.[25] This, in turn, is expected ultimately to reduce the cost or unpredictability of litigation against manufacturers and thereby remove a disincentive to vaccine research, development, and production. This is a lot to ask of one benefit program. The viability of the commercial vaccine industry cannot hinge on the success or failure of the Program.[26] But, to the

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A. Vaccine Injury Compensation Technicals, 101st Cong. 1st Sess., at 513 (Nov. 21, 1989). The amendments were enacted as section 6601 of the OBRA of 1989, Pub. L. No. 101-239, December 19, 1989, effective January 19, 1989.

[23] Representatives of some vaccine manufacturers testified before Congress that liability threatened the availability of vaccines. Both Congress and vaccine manufacturers remembered the difficulties surrounding swine flu production in 1976, when Congress enacted the Swine Flu Program in the face of manufacturer's unwillingness to produce swine flu vaccine after their insurers refused to provide insurance. No one welcomed a repeat of that episode. *See* R. Neustadt & H. Fineberg, THE SWINE FLU AFFAIR: DECISIONMAKING ON A SLIPPERY DISEASE (U.S.D.H.E.W. 1978). Although no data were presented to Congress to substantiate the assumption that liability costs represented an onerous proportion of revenues, it was widely accepted that the difficulties both in predicting liability costs and in obtaining liability insurance might discourage manufacturers from pursuing vaccines, especially when vaccines did not generate substantial profits. *See* VACCINE AND INNOVATION 45-64.

[24] The Act also limits the causes of action available under state tort law for damages resulting from a covered vaccination, 42 U.S.C. 300aa-22, prohibits most awards of punitive damages in such cases, and divides the action into separate stages for determining liability, general damages, and, if applicable, punitive damages. 42 U.S.C. 300aa-23. These provisions reinforce the attractiveness of pursuing compensation through the Program by eliminating or narrowing manufacturer liability in tort. However, they prohibit states from imposing stricter limits on the remaining causes of action. Mariner, *The National Vaccine Injury Compensation Program in the United States: A Preliminary Overview*, in S.R. Shulman & L. Lasagna, TRENDS IN PRODUCT LIABILITY LAW AND NO-FAULT COMPENSATION FOR DRUG-INDUCED INJURIES 41,44 (Tufts Univ. 1990).

[25] The House Committee on Energy and Commerce noted its expectations in its Report: "The Committee anticipates that the speed of the compensation program, the low transaction costs of the system, the no-fault nature of the required findings, and the relative certainty and generosity of the system's awards will divert a significant number of potential plaintiffs from litigation." House Rep. 99-908 at 6354.

[26] The decisions of manufacturers to pursue vaccine research, development, and sales are influenced by many factors, including the potential market for vaccines, the price of vaccines obtainable in the market, the costs of research and production, the degree to which the technology used is transferrable to or from other products, the public relations value of vaccines, and the

extent that vaccine related litigation deters manufacturers from pursuing vaccines, the Program may eliminate a negative influence on the decision.

Congress recognized that the Program could offer a comparative advantage over litigation only if it could assure speedy compensation. Moreover, a prompt award was the major justification for limiting the compensation payable to recipients.[27] The House Committee on Energy and Commerce 1986 Report on the original bill before Congress described the Program as "a 'no-fault' compensation program under which awards can be made to vaccine-injured persons quickly, easily, and with certainty and generosity."[28] It believed that the Program was "fair, simple, and easy to administer."[29] Programmatic efficiency is of paramount importance to the Program's success.

Congress made two key innovations to achieve this simple, streamlined system. The first was a policy decision to define the injuries eligible for compensation in the Act--the Vaccine Injury Table. This was intended both to avoid the controversy over what disabilities were in fact caused by vaccines, and to expedite decisions on claims by eliminating difficult, time-consuming disputes over causation in individual cases. A critical structural element of the Program, therefore, incorporates a policy decision. It is complicated by exceptions to the general rule; petitioners are entitled to compensation if they can prove their injuries were actually caused by a covered vaccine, even if not listed in the Table; and compensation can be denied where the injury is shown to result from an independent cause. As a result, perceptions of the utility of the Vaccine Injury Table are often colored by one's agreement or disagreement

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availability and cost of liability insurance. *See* Institute of Medicine, VACCINE SUPPLY AND INNOVATION 45-64 (1985).

[27] "The Committee notes that much of the equity in limiting compensation and limiting other remedies arises from the speed and reliability with which the petitioner can expect judgment; without such quick and certain conclusion of proceedings, the compensation system would work an injustice upon the petitioner." House Rep. 99-908 at 6358.

[28] *Id.* at 6344.

[29] *Id.* at 6348. The Committee Report is replete with references to the speed and fairness of the system: "The system is intended to be expeditious and fair." *Id.* at 6353. "The Committee has endeavored to create a swift, uncomplicated compensation system..." *Id.* at 6357. "In order to expedite the proceedings, the power of the Special Master is intended to replace the usual rules of discovery in civil actions in Federal courts." *Id.* at 6357. "The entire proceeding...is to take place as expeditiously as possible and, in no case, should take more than one year." *Id.* at 6358. When the Act was amended in 1989, Congress reiterated its original intent. The Conference Report noted that "Congress intended a quick, flexible, and streamlined system." Conference Report No. 101-386 to accompany H.R. 3299, Omnibus Budget Reconciliation Act of 1989, Subt. D.A. Vaccine Injury Compensation Technicals, 101st Cong. 1st Sess., p. 512 (Nov. 21, 1989). It intended that the "system be informal, flexible, and expeditious." *Id.* at 513.

with the policy choices embodied in the Table. The Program's experience with the Vaccine Injury Table is discussed in Chapter III.

The second innovation made by the Program was lodging decisionmaking authority with a self-contained unit of special masters within the U.S. Claims Court. This created a special hybrid programmatic structure that contains elements of administrative benefit determination systems and traditional litigation. The Program's experience with this new format for awarding federal benefits is discussed in Chapters IV and V.

The Vaccine Injury Compensation Program may be a creative solution to a complex problem. Its operation to date suggests that it has the potential to be one. But the issues of immunization policy, vaccine supply, and compensation for adverse reactions are multifaceted. There is a danger that the Program might founder in the face of expectations that it cannot reasonably be expected to meet. The most immediate objective of implementing a simple, streamlined system is itself a lofty goal, given the absence of ready precedents.

# Chapter II. The National Vaccine Injury Compensation Program: The Resulting Legislation

The National Vaccine Injury Compensation Program (Program) has been operating for more than a year and a half. It represents a creative policy measure intended to resolve some of the complex problems affecting immunization policy in the United States. Yet the program has faced an unusual array of difficulties in its short existence. It did not become effective until October 1, 1988, almost 2 years after it was signed into law. It did not begin to consider petitions for compensation for another 4 months. Then, in mid-1989, the Program was threatened with collapse when the Departments of Health and Human Services and Justice felt themselves unable to participate.

In response, in December 1989, Congress amended the statute in several procedural respects.[30] Thus, while the Program has operated continuously since February 1989, it has had two slightly different decisionmaking procedures. The major difference between the two is the degree of authority granted to the special masters. Under the original Program, the special masters made recommendations to the United States Claims Court and a Claims Court judge made the final decision. This original procedure is being applied to all petitions filed before January 19, 1990 when the Technical Amendments took effect. The New Rules apply the changes made by the

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[30] Vaccine Injury Compensation Technicals, Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-329, section 6601, December 19, 1989. For a discussion of the impetus for the Technical Amendments, *see* text accompanying note 172.

Technical Amendments to petitions filed on or after January 19, 1990, and permit the special master to make the final decision. When all pre-January 19, 1990 petitions have been decided, only the New Rules will apply.

## Eligibility

The Program provides compensation for persons who have died or received specified injuries following immunization with any of the covered vaccines against seven infectious diseases of childhood. The vaccines, whether given individually or in combination with other vaccines, are: diphtheria toxoid, tetanus toxoid, pertussis vaccine (usually combined as DTP), measles, mumps, and rubella vaccines (often combined as MMR), oral poliovirus vaccine (OPV), and inactivated poliovirus vaccine (IPV).

Persons who received vaccines before the Program went into effect, as well as those receiving vaccines on or after the effective date, may be eligible. The Program has two categories of petitioners. Persons who received a vaccine before the effective date of October 1, 1988, bring "retrospective cases." Persons who were immunized on or after October 1, 1988, bring "prospective cases." The classification of cases into prospective and retrospective categories serves to distinguish petitioners entitled to different treatment under the Program.

Eligibility for compensation is based on the type of vaccine, the specific disease or medical condition suffered, and U.S. citizenship or residence at the time of vaccination. Eligibility requirements are summarized in Table II-1 below. Although the Program was inspired out of concern for children who suffered injury as a result of immunizations that are required for school entry, it covers injuries to adults as well, and specifically mentions those who suffered paralysis after contact with a person (ordinarily an infant) who was vaccinated with oral polio vaccine.[31]

The Program offers an alternative source of compensation for persons with adverse reactions to vaccines who might institute a civil action in tort for damages for personal injury. All persons who were immunized with a covered vaccine on or after October 1, 1988, are prohibited by the Act from commencing a civil action for a vaccine-related injury unless and until they have entered the Program and received a determination thereunder.[32] For these "prospective cases," the Program is a first-resort but not exclusive source of possible compensation.[33]

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[31] The Act does not limit recipient cases to children, although adults do not ordinarily receive the covered vaccines. The so-called "contact cases" of polio resulting from contact with an infant who was immunized with oral polio vaccine are the only nonrecipient cases covered by the Program. 42 U.S.C. 300aa-11(c)(1)(A), (c)(1)(B)(ii). Live virus from the vaccine may be excreted by a vaccinated infant and, in rare cases, infect a person, such as a parent or caretaker, who handles the infant or contaminated diapers or clothing.

Persons who were vaccinated before October 1, 1988, may either enter the Program[34] or commence a civil action for damages for a vaccine-related death or injury, subject to several limitations. Many such persons with "retrospective cases" may have already commenced a civil action for their injuries. If the action has been completed and they did not recover any damages, they may enter the Program.[35] If the action is still pending, they have the option of either proceeding with their civil action or dismissing it and seeking compensation from the Program; they may not do both.[36] However, a person who has already recovered compensation as a result of a judgment or settlement of a civil action for the same injury is not eligible for the Program, regardless of the amount of compensation recovered.[37] These rules allow persons who were injured before the Act took effect to obtain its benefits as long as they have not received (and are not pursuing) damages in tort litigation. A person who files a civil action after November 15, 1988, with respect to a vaccination given before October 1, 1988, is not eligible for the Program.

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[32] 42 U.S.C. 300aa-11(a)(2)(A).

[33] Prospective cases must be filed within 36 months after the first symptom or onset of injury occurs. 42 U.S.C. 300aa-16(a)(2). In the case of death, prospective cases must be filed within 24 months after the date of death and no later than 48 months after the first symptom or onset of the injury from which death resulted. 42 U.S.C. 300aa-16(a)(3).

[34] Retrospective cases must be filed within 24 months after the October 1, 1988 effective date. 42 U.S.C. 300aa-16(a)(1). The last day for filing will be October 1, 1990, since September 30, 1990 is a holiday.

[35] 42 U.S.C. 300aa-11(a)(4).

[36] 42 U.S.C. 300aa-11(a)(5).

[37] 42 U.S.C. 300aa-11(a)(7).

## Table II-1

*Vaccine Injury Compensation Program Eligibility Requirements*

1. Received one of the following vaccines, alone or in combination:

    diphteria, tetanus, pertussis
    polimyellitis (OPV or IPV),
    measles, mumps, rubella;

    Or contracted polimyelitis from a person who received an oral polio vaccine.

2. Received the vaccine:

    - in the United States (or its trust territories); or
    - outside the United States while a U.S. citizen who was:
        - serving in U.S. armed forces or
        - employee of U.S. government, or
        - dependent of such a citizen

    OR

    - outside the United States and returned to the United States within 6 months if vaccine was manufactured by U.S. manufacturer;

    OR

    Contracted polio while a U.S. citizen (or a dependent of U.S. citizen) from a person who received oral polio vaccine

3. Suffered:

    - death listed in Vaccine Injury within time specified in Vaccine Injury Table, or
    - injury listed in Vaccine Injury Table within time specified in Vaccine Injury Table that lasted more than 6 months, and resulted

in more than $1,000 in unreimbursable expenses, or
- injury or death caused by covered vaccine.

4. Has not previously collected an award or settlement of a civil action for damages for the injury or death.

Source: 42 U.S.C. 300aa-11(c).

## Review of Claims

Eligibility for compensation is determined by the United States Claims Court.[38] As originally enacted, the Act provided for designated special masters in the Claims Court to make recommendations to the Court on eligibility and amounts of compensation in all cases.[39] The Claims Court was the final decisionmaker, with broad powers to review and accept or modify the special master's findings or to make a de novo determination.[40] Under recent amendments to the Act, which became effective January 19, 1990 (the Technical Amendments),[41] the special master is authorized to make the final determination on eligibility and the amount of compensation.[42] This new format, sometimes called the "New Rules", creates a specialized group of decisionmakers within the Claims Court whose sole function is to make benefit determinations under the Program.

Claims for compensation are made by submitting a petition claiming eligibility to the Claims Court, and serving a copy on the Secretary of Health and Human Services.[43] The Secretary is the sole named respondent in the proceedings. No manufacturer or other person who might be responsible for any injury may intervene or participate as a party to the proceedings. The National Vaccine Injury Compensation Program Office (Program Office) has been created within the Department of Health and Human Services, Public Health Service, Health Resources and Services Administration, Bureau of Health Professions, to review petitions and act on behalf of the Secretary with respect to the Program. The Program Office reviews each petition to determine whether a petitioner has met the eligibility requirements. In particular, at least one physician reviews the information concerning the injury or death to determine whether it qualifies as a compensable event defined in the Act. Although the Act does not specify the Secretary or Program Office's responsibilities, its designation as respondent obliges it to respond to petitions. Thus, its opinion is submitted to the presiding special master as an answer to the petition.[44]

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[38] The Act grants the Claims Court and its special masters "jurisdiction over proceedings to determine if a petitioner ... is entitled to compensation under the Program and the amount of such compensation...." 42 U.S.C. 300aa-12(a).

[39] 42 U.S.C. 300aa-12(c)(2) (1987) originally described the special master as an adjunct to the Court and required the special master to "prepare and submit to the court proposed findings of fact and conclusions of law." The Program began with eight special masters to work full time on Program petitions, although all eight special masters were not in place until the end of March 1989. As of July 1990, only six special masters will be assigned to the Program.

[40] 42 U.S.C. 300aa-12(d) (1987).

[41] *See* note 30.

[42] 42 U.S.C. 300aa-12(d)(3)(A) (1990). The Claims Court now acts as an appellate body with limited power to review a special master's determination upon objection by either party. 42 U.S.C. 300aa-12(e) (1990).

One special master is randomly assigned to an individual case and makes a determination as to eligibility on the basis of the evidence submitted by the petitioner and the Program Office. The critical issue in determining eligibility is whether the injury or death qualifies as a compensable injury as defined in the Act.[45] Although the Program is a compensation system limited to injuries presumed to result from one source--childhood vaccines--and not a general disability benefit program, it does not condition eligibility on causation in the traditional sense. Rather, it lists in the statute itself the medical conditions that are compensable.[46] This list is the Vaccine Injury Table shown in Table II-2.

The Vaccine Injury Table lists the types of compensable medical conditions and the time within which they must occur to qualify for compensation. The medical conditions listed in the Table were derived from existing epidemiologic studies of adverse reactions to the covered vaccines and reports of the American Medical Association and the American Academy of

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[43] 42 U.S.C. 300aa-11(a)(1). Under the Vaccine Rules adopted by the Claims Court January 18, 1990, the original plus two copies of the petition should be filed with the Clerk of the Court. Vaccine Rule 2(a), U.S. Claims Court General Order No. 26 (Jan. 28, 1990) (hereafter Vaccine Rules). Both the Act and the Vaccine Rules specify service upon the Secretary, 42 U.S.C. 300aa-11(a)(1), Vaccine Rule 2(c); the Secretary's authority to participate in the Program has been delegated to the Director of the Program within the Bureau of Health Professions. The Vaccine Rules helpfully include the mailing addresses of the Clerk and the Secretary.

[44] The Program office is now represented by attorneys from the Department of Justice, Civil Division. They incorporate the medical review into an answer accepting or objecting to each petition.

[45] 42 U.S.C. 300aa-11(c)(1)(C).

[46] 42 U.S.C. 300aa-14(a). Compensable medical conditions include acute complications and sequela.

Pediatrics. While they represent an effort to approximate a list of conditions that are thought to be caused by the vaccines, they are not intended to precisely reproduce actual causation. Congress recognized that the Table favored compensating some persons whose injuries were not in fact caused by a vaccine. Nonetheless, it was expected that the savings in time and expense over a system based on causation-in-fact would more than offset the small number of such cases. The statute also includes "qualifications and aids to interpretation," that define medical conditions like encephalopathy and describe symptoms that should and should not be considered indications of a Table injury.[47] In addition, the Secretary is authorized to revise the Table by adding or deleting compensable conditions or the time of onset.[48]

Injuries that are found by the special master to result from a cause other than a covered vaccine are not eligible for compensation,[49] so there is a check on the reach of the Vaccine Injury Table. At the same time, petitioners are entitled to prove that an injury was in fact caused by a covered vaccine even if it is not listed in the Vaccine Injury Table or, if listed, even if it did not occur within the specified time period.[50] However, causation-in-fact must be proved by a petitioner without the benefit of the Table.

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[47] 42 U.S.C. 300aa-14(b).

[48] 42 U.S.C. 300aa-14(c). Revisions are to be made by regulation after notice and opportunity for public comment. Anyone may petition the Secretary for a revision, but all revisions must be reviewed by the Advisory Commission on Childhood Vaccines.

[49] 42 U.S.C. 300aa-13(a)(1)(B).

[50] 42 U.S.C. 300aa-13(c)(1)(C)(ii).

## Table II-2
### *Vaccine Injury Table*
42 U.S.C. 300aa-14(a)

I. DTP; P; DTP/Polio Combination; or Any other Vaccine Containing Whole Cell Pertussls Bacteria, Extracted or Partial Cell Bacteria, or Specific Pertussis Antigen(s). Illness, disability, injury, or condition covered: Time period for first symptom or manifestation of onset or of significant aggravation after vaccine administration:

A. Anaphylaxis or anaphylactic shock .......................... *24 hours*
B. Encephalopathy (or encephalitis) ................................ *3 days*
C. Shock-collapse or hypotonic-hyporesponsive collapse ....... *3 days*
D. Residual seizure disorder in accordance with subsection (b)(2) ........................................................................ *3 days*
E. Any acute complication or sequela (including death) of an illness, disability, injury, or condition referred to above which illness, disability, injury, or condition arose within the time period prescribed ........................................................ *not applicable*

II. Measles, mumps, rubella, or any vaccine containing any of the foregoing as a component; DT; Td; or Tetanus Toxoid.

A. Anaphylaxis or anaphylactic shock .......................... *24 hours*
B. Encephalopathy (or encephalitis) ............................... *15 days*
(for mumps, rubella, measles, or any vaccine containing any of the foregoing as a component). ........................................ *3 days*
(for DT,Td, or tetanus toxoid).
C. Residual seizure disorder in accordance with subsection (b)(2) ....................................................................... *15 days*
(for mumps, rubella, measles, or any vaccine
containing any of the foregoing as a component). ................ *3 days*
(for DT, Td, or tetanus toxoid).
D. Any acute complication or sequela (including death) of an illness, disability, injury, or condition referred to above which illness, disability, injury, or condition arose within the time period prescribed ........................................................ *not applicable*

III. Polio Vaccines (other than Inactivated Polio Vaccine).

A. Paralytic polio
--in a nonimmunodeficient recipient .......................... *30 days*
--in an immunodeficient recipient .......................... *6 months*
--in a vaccine-associated community case .......... *not applicable*

B. Any acute complication or sequela (including death) of an illness, disability, injury, or condition referred to above which illness, disability, injury, or condition arose within the time period prescribed ........................................................ *not applicable*

IV. Inactivated Polio Vaccine.

A. Anaphylaxis or anaphylactic shock .......................... *24 hours*

B. Any acute complication or sequela (including death) of an illness, disability, injury, or condition referred to above which illness, disability, injury, or condition arose within the time period prescribed ........................................................ *not applicable*

## Compensation

The compensation available under the Program varies with the date of vaccination. Petitioners with retrospective cases are entitled to the same types of compensation as those with prospective cases, but the amounts are more limited.

The categories of compensation available in prospective cases are: actual past and estimated future medical expenses, including rehabilitation and home care, that are not reimbursable by private insurance;[51] actual and future losses of earnings;[52] actual and projected pain and suffering and emotional distress not to exceed $250,000;[53] and reasonable attorneys' fees and costs.[54] Attorneys' fees may be awarded if the petition is determined to have been brought in good faith, regardless of whether the petitioner is ultimately determined to be eligible for compensation.[55] In the case of a person who died, the estate may receive a fixed death benefit in the amount of $250,000.[56]

Petitioners with retrospective cases are entitled to the same general categories of compensation, but special restrictions apply. A death benefit of $250,000 is payable in the event of death, as in prospective cases.[57] But only future unreimbursable medical and rehabilitation expenses are available; expenses incurred prior to the date of the Claims Court judgment are not allowed.[58] The remaining three categories of compensation--loss of earnings, pain and suffering, and attorneys' fees and costs--are limited to an aggregate amount of $30,000 for all three.[59]

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[51] Eligible expenses include the cost of reasonably necessary diagnostic, medical or other remedial care, and "rehabilitation, developmental evaluation, special education, vocational training and placement, case management services, counseling, emotional or behavioral therapy, residential and custodial care and service expenses [to enable the person to live at home], special equipment, related travel expenses, and facilities determined to be reasonably necessary." 42 U.S.C. 30011-15(a)(1)(A)(iii) and (B)(iii).

[52] For persons injured as adults (age 18 and over), actual and anticipated lost earnings are payable, as in litigation, computed in accordance with actuarial principles for expected future losses. 42 U.S.C. 300aa-15(a)(3)(A). Children who have a disability that can be demonstrated to reduce their future earning capacity may receive lost earnings calculated at the rate of average private, nonfarm wages, but these are payable only after the child reaches 18 years of age.

[53] 42 U.S.C. 300aa-15(a)(4).

[54] 42 U.S.C. 300aa-15(e).

[55] *Id.*

[56] 42 U.S.C. 300aa-15(a)(2). The statute does not expressly limit compensation to $250,000 in cases of death, so prospective cases may be entitled to other loses incurred before death.

[57] 42 U.S.C. 300aa-15(b).

[58] *Id.*

[59] *Id.* *See* text accompanying notes 137-140.

## Time for Review

Determinations on eligibility and the amount of compensation, if any, to be awarded are to be made within a relatively short time period compared with tort litigation. As originally enacted, the Act required a final judgment by the Claims Court within 365 days after the petition was filed. Under the New Rules, effective with respect to petitions filed on or after January 19, 1990, the decision is to be made within 240 days after filing.[60] However, this period may be extended up to an additional 180 days in certain circumstances.[61]

Under the New Rules, the special master's decision will ordinarily be the final determination under the Program.[62] However, either party--the petitioner or the Secretary--may request the Claims Court to review the decision of the special master by motion made within 30 days after the decision is issued.[63] The Claims Court is to review the decision in the manner of an appellate court with limited powers of review. The Court may set aside any finding of fact or conclusion of law only if it is found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[64] Alternatively, the Court may remand the case to the special master for further proceedings.[65] This review procedure is to be completed within 120 days after the motion for review has been responded to by the other party.[66] One final level of appeal is available. Either party, if aggrieved by the decision, may appeal to the United States Court of Appeals for the Federal Circuit.[67]

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[60] 42 U.S.C. 300aa-12(d)(3)(A)(ii).

[61] The special master may grant a one-time suspension of the proceedings upon motion by either the petitioner or the Secretary/Program Office. Thereafter, suspensions may be granted only if reasonable and necessary, and may not exceed 150 days in the aggregate. 42 U.S.C. 300aa-12(d)(3)(C). Thus, while the new time period is 4 months shorter than the year originally provided for, if all possible suspensions were granted, it could extend for 14 months. It is unclear whether this limit is jurisdictional, or merely a goal.

[62] As originally enacted, the special master merely submitted proposed findings of fact and conclusions of law to the Claims Court. The Claims Court had sole power to issue a final judgment and could hear a case de novo, as well as modify or reject specific findings and remand for additional proceedings.

[63] 42 U.S.C. 300aa-12(e)(1).

[64] 42 U.S.C. 300aa-12(e)(2)(B). If the Court does set aside any element of the special master's decision, it may issue its own findings of fact and conclusions of law. *Id.*

[65] 42 U.S.C. 300aa-12(e)(2). The Court must limit remand proceedings to not more than 90 days.

[66] 42 U.S.C. 300aa-12(e)(2). The responding party has 30 days in which to file a response to the request for review. 42 U.S.C. 300aa-12(e)(1).

[67] The appeal must be filed within 60 days after the Claims Court's final judgment is filed. 42 U.S.C. 300aa-12(f). There may be a question about whether the judgment is final enough to

Since the Program is an alternative, not an exclusive, source of compensation, each petitioner has the option to accept or reject the decision made on his petition. A petitioner must elect to accept or reject the decision within 90 days after the final judgment, or the judgment on appeal.[68] If the decision awarded the petitioner compensation, the award becomes payable. If a petitioner does not accept the judgment, he may file a civil action for damages for the vaccine-related injury or death.[69]

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merit appeal, since the petitioner may elect to reject it. However, it is the Program's final decision.

[68] 42 U.S.C. 300aa-21(a). Failure to file an election with the Clerk of the Claims Court is deemed an election to accept the decision. *Id.*

[69] Petitioners in retrospective cases who had dismissed pending civil actions without prejudice before entry into the Program may reject the Program's judgment and reactivate their civil actions. Petitioners with prospective cases may not commence a civil action prior to going through the Program. If they reject the Program's judgment, they may institute a civil action. State and federal statutes of limitation applicable to the civil action are tolled until the final judgment is issued under the Program, but not until the date of an election.

## Payment of Awards

Compensation awarded under the Program becomes payable only after a petitioner has filed an election to accept the judgment.[70] The Act originally required awards to be paid in a lump sum, with payments in retrospective cases being made in four equal annual installments. The Technical Amendments added some flexibility to the payment options by allowing the special master to use all or part of the award to purchase an annuity or other payment mechanism that would best serve the petitioner's interests.[71]

Awards in the prospective cases are to be paid out of a new Vaccine Injury Compensation Trust Fund that is intended to become self-sustaining in the long run. The Trust Fund is to be funded by taxes on vaccine manufacturers based on covered vaccine sales.[72] Congress separately appropriated $80,000,000 out of general revenues for each of the fiscal years 1989 through 1993 to fund awards in retrospective cases.[73] In addition, Congress limited the number of retrospective cases in which the Program could award compensation to 3,500.[74] If appropriations are insufficient to permit payment of any award, the petitioner who is entitled to the payment is exempted from the prohibition against bringing a civil action for damages.[75]

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[70] 42 U.S.C. 300aa-15(f)(1).

[71] Payments that are in neither lump sum nor annuity form require the petitioner's consent. It is not clear from the statutory language whether purchasing an annuity also requires the petitioner's consent. Compensation is to be paid in a lump sum or installments "of which all or a portion of the proceeds may be used as ordered by the special master to purchase an annuity or otherwise be used, with the consent of the petitioner, in a manner determined by the special master to be in the best interests of the petitioner." 42 U.S.C. 300aa-15(f)(4)(A), (B). In practice, special masters seek the petitioner's agreement to all payment methods.

[72] Internal Revenue Code, sec 9510. The taxes specified currently per dose of vaccine are: DTP--$4.56; MMR--$4.44; Polio--$0.29; DT--$0.06. The Trust Fund now contains approximately $290,000,000.

[73] 42 U.S.C. 300aa-15(j).

[74] 42 U.S.C. 300aa-11(b)(2).

[75] 42 U.S.C. 300aa-15(4)(B).

## Summary

The Program creates a "no-fault" alternative system for providing compensation for vaccine-related deaths and injuries. Its programmatic structure represents an innovation in federal benefit systems. It is not a general benefit or entitlement program based on injury alone because compensation is limited to injuries from a single source. It does, however, provide compensation to injured persons regardless of the presence or absence of any product defect or negligence. It is "no-fault" in the sense that compensation is not predicated on establishing that the injury was the fault or legal responsibility of any person or entity. Those who produced or distributed the vaccine or administered the immunization play no role in the Program. However, manufacturers contribute to the Trust Fund by means of the vaccine surtax. In this sense, it is similar to worker compensation programs. However, it is not the exclusive remedy or source of compensation for such injuries. The option of pursuing a civil action is preserved, subject to compliance with certain prerequisites. The Program is an optional alternative, though not additional, source of compensation for uncompensated injuries occurring before the Program took effect. For prospective cases, it is a first-resort alternative to civil actions for damages, conceptually akin to an administrative remedy that must be pursued before resort to the court is permitted. Again, however, the Program is an **alternative** to civil actions because claimants may not obtain compensation from both the Program and litigation.

The Program is cause-based in the sense that compensation is available only for injuries that are presumed to result from one source--required childhood vaccines. However, the concept of causation is given a new twist in order to expedite the process of determining claims for compensation. Proof of causation-in-fact--that a vaccine actually caused the injury in question--is presumed for certain medical conditions listed in the Vaccine Injury Table. The Act thus creates a Program based on causation-in-law, whereby the statute defines the nature of injuries that will qualify for compensation. Causation-in-fact is preserved, however, to permit compensation in cases in which injuries are actually caused by a covered vaccine, even though not included in the Vaccine Injury Table, and to preclude compensation in cases in which something other than a vaccine actually caused the injury.

The Program offers the promise of an expeditious award of compensation for anyone who has suffered a vaccine-related death or injury. The time required for deciding cases--ordinarily 1 year or less--is quite short. Although in some cases awards may be less than might be recoverable in civil actions for damages, they are swifter and more certain than litigation can promise. If the

Program functions smoothly, potential petitioners may be attracted to the Program as an alternative to litigation.

The differential treatment of retrospective and prospective cases found in the Program underscores an unusual feature: the extension of benefits to persons with injuries that occurred before the Act took effect. Such persons were influential in convincing Congress of the need for the Act. A compensation system with the normal prospective application would have been a victory for the principle of assisting persons with adverse reactions to vaccines, but it would have left them unaided. Congress attempted to fashion a system that would extend the benefits of the Program to those who exemplified its intended beneficiaries without depleting scarce revenues. Ultimately, it did so by limiting both the number and amount of awards payable in retrospective cases.

As in any new benefit program, there remain many questions about its ability to function smoothly and achieve its objectives. The Program's requirements are spelled out in considerable detail in the Act creating it. Yet there remain ambiguities in the statute that will require some interpretation. The Act requires all concerned to function in new roles. Ultimately, the attitudes of all those who come into contact with the Program and their ability and willingness to work within its framework will determine whether it can help to solve or exacerbate the problems it was designed to address. The remaining chapters offer some preliminary information to begin to answer such questions.

# Chapter III. The Vaccine Injury Table: Questions of Policy and Proof

The Program's use of the Vaccine Injury Table represents a departure from the structure of most federal compensation or disability benefit programs in this country. Eligibility for these programs generally is defined as a stated level of functional physical or mental disability or inability to perform gainful work, rather than a specific disease or medical condition. In addition, such programs ordinarily specify only the severity of injury by statute, leaving it to the administrative agency to develop rules or informal guidelines for determining what qualifies as an eligible disability.[76] The Program also differs from vaccine injury compensation programs in other countries for the same reasons.[77]

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[76] For example, the general definition of disability in the Social Security Old Age, Survivors and Disability Insurance Program, 42 U.S.C. 416(I), 423(D)(1)(A), is "inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last...not less than 12 months." See also, Railroad Retirement Act, 42 U.S.C. 321a(a)(1)(iv) and

The Black Lung Benefits Act[78] is the closest precedent for the Program in that it compensates coal miners who are totally disabled due to pneumoconiosis or black lung disease. Moreover, there was some uncertainty, if not controversy, over the causal relationship between black lung disease and coal mining, at least in individual cases. Congress responded to the plight of the miners by creating presumptions, such as those that broadly define pneumoconiosis to include a wider range of respiratory problems than black lung disease strictly defined, that favor compensating claimants.[79] The Vaccine Injury Compensation Program emerged from a somewhat similar history and embodies a somewhat similar presumption that gives claimants the benefit of the doubt to permit compensation in a large proportion of cases.

The Vaccine Injury Table was adopted to eliminate disputes over whether an individual's death or injury was actually caused by a particular immunization.[80] Proving causation-in-fact is perhaps the most time-consuming and expensive element of civil actions for personal injury. This is especially true in civil tort actions claiming injury from adverse reactions to vaccines. By substituting the Vaccine Injury Table's list of compensable events for a requirement that causation be proved, Congress intended to remove the problematic issue of causation and create a prompt decisionmaking process.

There is no doubt that Congress recognized that the Table it drafted was merely a best estimate presumption of causation and that it would permit compensating some cases that may not actually have been caused by a vaccine. In its Report on the bill as originally adopted, the House Committee on Energy and Commerce said:[81]

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(v); Federal Employees Retirement System 5 U.S.C. 8451(a)(1)(B) (Supp. IV 1986); Veterans Disability Program, 5 U.S.C. 8337(a).

[77] Compensation systems created by statute in Denmark, the Federal Republic of Germany, France, Japan, Switzerland, and the United Kingdom also base eligibility on the severity of injury rather than a list of compensable medical conditions and require a determination that the vaccine caused the injury. See Mariner, *Compensation Programs for Vaccine-Related Injury Abroad: A Comparative Analysis*, 31 ST. LOUIS U. L. J. 599 (1987).

[78] 30 U.S.C. 901-945.

[79] Bloch, *The Use of Medical Personnel in Social Security Disability Determinations* 20 (Administrative Conference of the United States 1989).

[80] The House Committee on Energy and Commerce said the Program was intended "to compensate persons with recognized vaccine injuries without requiring the difficult individual determinations of causation of injury." House Rep. 99-908 at 6353.

[81] H.R. Report No. 99-908, 99th Cong., 2d Sess., pt. 1, at 18 (1986), U.S. Code Cong. & Admin. News 1986, at 6287, 6359.

> The Committee recognizes that there is public debate over the incidence of illnesses that coincidentally occur within a short time of vaccination. The Committee further recognizes that the deeming of vaccine-relatedness adopted here may provide compensation to some children whose illness is not, in fact, vaccine-related.

The Committee Report went on to explain that ongoing research could provide better information on the incidence of vaccine injury, and that the Secretary or the Advisory Commission on Childhood Vaccines could propose appropriate revisions in the Table based on new information.[82] "Until that time, however," continued the Committee, "the Committee has chosen to provide compensation to all persons whose injuries meet the requirements of the petition and the Table and whose injuries cannot be demonstrated to be caused by other factors."[83]

All of the reported Claims Court decisions that have considered the issue have concluded that a petitioner who demonstrates that an injury listed in the Table occurred within the specified time period has satisfied his burden of proof as to a Table injury. As one decision put it, "Temporal association alone establishes legal causation for a Table injury."[84]

In practice, this has proved easier said than done. In the opinion of the Program Office, fewer than a quarter of the petitions it reviewed by March 1990 demonstrated a condition that qualified as a Table injury or death. It thus recommended against awarding compensation in almost three quarters of the cases it reviewed. Table III-1 shows the recommendations of the Program Office, together with the decisions of the Claims Court, in cases decided as of March 27, 1990. Table III-2 contains the recommendations and decisions that involved DTP vaccine, together with Claims Court decisions, by the injuries set forth in the petition. It can be seen that petitioners and the Claims Court often disagree with the Program Office on what medical conditions constitute a Table injury.

It appears that most petitioners believe that their injuries are listed in the Table. They considered the Program Office's opposing opinion to evidence disagreement with the Table itself. In other words, the Program Office was seen as disputing the accuracy of the conditions listed in the Vaccine Injury

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[82] *Id.* The part of the Act that was intended to encourage research was not funded until 1989.

[83] *Id.*

[84] Shaw v. Secretary, 18 Cl. Ct. 646, 650 (1989). This and other decisions have distinguished "legal causation":--the presumption used in the Act--from "causation in fact" as used in civil tort actions.

Table, presumably because it did not consider some conditions to be likely to be caused by the vaccine at all. This attitude, some believed, led the Program Office to search at length for what it considered to be the real cause of injury, even in cases in which the petitioner's injury was described in the Table. They felt this ignored the Table as a substitute for actual causation and was inconsistent with the Program's purpose and structure.

Even the Program Office concedes that it was conflicted initially in its ability to apply the Table to specific petitions. Because medical reviewers were familiar with the medical literature on adverse reactions to vaccines and the frequent difficulty of identifying individual cases, they could not help reacting skeptically to a statutory listing of conditions that seemed to them to ascribe actual causation. Perhaps inevitably, their awareness of the range of possible causes of neurological injury and death inspired them to consider all potential sources of injury, even in cases in which no other cause was apparent. This search for nonvaccine causes antagonized several petitioners and their attorneys, who felt that they had clear evidence of an injury defined in the Table and no indication of any other possible cause.

## Table II-1

### *Comparison of Program Office Recommendations and Judgments as of March 27, 1990 (All Vaccines)*

| | Program Office Recommendation | | | | Claims Court Judgment | |
|---|---|---|---|---|---|---|
| | Table Injury | | Award Compensation | | Award Compensation | |
| Vaccine | Yes | No | Yes | No | Yes | No |
| DTP or P | 11 | 38 | 11 | 38 | 44 | 5 |
| % | 22.4 | 77.6 | 22.4 | 77.6 | 89.9 | 10.2 |
| DT | 1 | 0 | 1 | 0 | 1 | 0 |
| % | 100 | 0 | 100 | 0 | 100 | 0 |
| Polio | 1 | 0 | 1 | 0 | 1 | 0 |
| % | 100 | 0 | 100 | 0 | 100 | 0 |
| MMR | 2 | 4 | 2 | 4 | 5 | 1 |
| % | 33.3 | 66.7 | 33.3 | 66.7 | 83.3 | 16.7 |
| Total | 15 | 42 | 15 | 42 | 51 | 6 |
| % of Total | 26.3 | 73.7 | 26.3 | 73.7 | 89.5 | 10.5 |

## Table III-2

*Program Office Recommendations and Final Judgments in DTP Cases as of 3/27/90*

| | Program Office Recommendation | | | | Claims Court Judgment | |
|---|---|---|---|---|---|---|
| Injury Stated in Petition | Table Injury Yes | No | Award Compensation Yes | No | Award Compensation Yes | No |
| Hypotonic-Hyporesponsive State or Collapse (HH) | 0 | 2 | 0 | 2 | 2 | 0 |
| Residual Seizure Disorder (RSD) | 2 | 1 | 2 | 1 | 3 | 0 |
| Encephalopathy or Encephalitis (E) | 0 | 1 | 0 | 1 | 1 | 0 |
| Death (D) | 0 | 0 | 0 | 0 | 0 | 0 |
| Shock Collapse (SC) | 0 | 0 | 0 | 0 | 0 | 0 |
| RSD&E | 3 | 8 | 3 | 8 | 9 | 2 |
| RSD & D | 2 | 0 | 2 | 0 | 2 | 0 |
| RSD,E&D | 0 | 1 | 0 | 1 | 1 | 0 |
| HH & D | 0 | 3 | 0 | 3 | 3 | 0 |
| HH,E & D | 1 | 8 | 1 | 8 | 9 | 0 |
| E & D | 2 | 5 | 2 | 5 | 7 | 0 |
| SC & D | 0 | 1 | 0 | 1 | 1 | 0 |
| E, HH, RSD & D | 0 | 1 | 0 | 1 | 1 | 0 |
| E, SC, RSD & D | 0 | 1 | 0 | 1 | 1 | 0 |

| | Program Office Recommendation | | | | Claims Court Judgment | |
|---|---|---|---|---|---|---|
| Injury Stated | Table Injury | | Award Compensation | | Award Compensation | |
| in Petition | Yes | No | Yes | No | Yes | No |
| Anaphylaxis (A), HH & D | 0 | 1 | 0 | 1 | 1 | 0 |
| A & E | 0 | 1 | 0 | 1 | 1 | 0 |
| A, HH, E & D | 0 | 2 | 0 | 2 | 1 | 1 |
| Allergic Reaction & D | 0 | 1 | 0 | 1 | 0 | 1 |
| Learning Disabilities | 0 | 1 | 0 | 1 | 0 | 1 |
| Unspecified | 1 | 0 | 1 | 0 | 1 | 0 |
| TOTAL | 11 | 38 | 11 | 38 | 44 | 5 |
| Percent | 22.4 | 77.6 | 22.4 | 77.6 | 89.9 | 10.2 |

## The Function of the Vaccine Injury Table

The controversy over Table injuries raises both practical and conceptual problems. The practical problem is that causation-in-fact has become a disputed issue in a substantial number of cases, undermining the Program's intended efficiency. This is discussed in greater detail below.

The conceptual problem is the function of the Vaccine Injury Table; that is, whether the Table represents Congress' best estimate of causation in fact or merely definitions of compensable injuries. If, as the Program Office appeared to believe in the early months of operation, the Table is supposed to present a reasonably accurate list of adverse reactions actually caused by vaccines, one might believe that only those cases that are proved to be the specific result of a vaccine are eligible for compensation. That belief might be reinforced by the Act's provision for denying compensation in cases in which an unrelated factor was determined to cause the injury. However, Congress made clear that the Table was to serve as a substitute for proving causation-in-fact. Although it was compiled from the best estimates of causation available, its application was not intended to depend upon its accuracy in any individual case.[85] Once compiled and enacted, the Table was a list of compensable injuries. Recourse for those who disagree with the conditions listed in the Table lies in amending the Table.

To date, there has been no formal effort to amend the Table. However, renewed controversy over whether specific permanent injuries, such as encephalopathy and death, have resulted from the DTP vaccine raises the possibility. Although Congress contemplated revisions if new scientific information proved the Table to be in error, changes in the conditions listed for DTP vaccine could threaten the Program's future.

In February 1990, an article in the British medical journal *The Lancet* reevaluated the 1981 British National Childhood Encephalopathy Study, on which much opinion about adverse reactions is based, in light of a more recent assessment of its results and the decision in the British *Loveday* case.[86] It concluded that pertussis vaccine probably poses no risk of permanent neurological damage and that the British vaccine injury compensation system should be repealed. A study published in a March 1990 issue of the *Journal of the American Medical Association* reported that there was no increased risk of febrile, afebrile or acute symptomatic seizures in the days after immunization with DTP as compared with 30 or more days after immunization.[87] The study results contrast with earlier studies that found an increased risk of febrile seizures in the immediate post-immunization period (3.7 times that of the period 30 days or more after immunization).[88] However, the authors warned that their findings with respect to febrile seizures must be viewed with caution, in part because the study design may have caused them to miss cases that were not seen in a hospital or recorded in the medical record.

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[85] *See* text accompanying notes 81-84.

[86] Bowie, *Lessons from the Pertussis Vaccine Court Trial*, 335 LANCET 397 (1990). *See, also*, Griffith, *Permanent Brain Damage and Pertussis Vaccination: Is the End of the Saga in Sight?* 7 VACCINE 199 (1989).

An editorial accompanying the JAMA study argued that these studies demonstrated that DTP vaccine could not cause encephalopathy.[89] The editorial called the Program a "new national tragedy[90] because the Vaccine Injury Table lists encephalopathy as a compensable injury resulting from pertussis or DTP vaccine.[91]

Such articles have revived a controversy that the Program was intended, in part, to avoid: whether pertussis causes encephalopathy, seizures or death. The Institute of Medicine has convened a committee to review estimates of adverse reactions to pertussis vaccine and generally to take a fresh look at the evidence linking pertussis with adverse reactions.[92] Its report, not due until May 1991, is not likely to settle the issue, although it could shed some light on the quality of the scientific data available.

Whatever the merits of pertussis vaccine encephalopathy, the controversy lies at the heart of Program--both its *raison d'etre* and its administrative functioning. Adverse reactions to the diphtheria-tetanus-pertussis (DTP) vaccine were the primary concern of organized parents who supported the adoption of the Act. They also constitute the overwhelming preponderance of claims in petitions filed and decided (81.6percent) under the Program.

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[87] Griffin, Ray, Mortimer, Fenichel & Schaffner, *Risk of Seizures and Encephalopathy after Immunization with the Diphtheria-Tetanus-Pertussis Vaccine*, 263 J. AM. MED. ASSN. 1641 (March 23/30, 1990). The study followed 38,171 children who received at least one DTP immunization in the Tennessee Medicaid program for about 3 years after birth. Less than 1 percent (0.9 percent or 356) of the children had a hospital medical record of having a seizure or encephalopathy within 14 days after DTP immunization. Only 2 children had encephalopathy, both more than two weeks after immunization, and neither had any permanent injury.

[88] Walker, Jick, Perera, Knauss, & Thompson, *Neurological Events Following Diphtheria-Tetanus-Pertussis Immunization*, 81 PEDIATRICS 345 (1988).

[89] Cherry, *"Pertussis Vaccine Encephalopathy": It Is Time To Recognize It As The Myth That It Is*, 263 J. AM. MED. ASSN. 1679 (1990).

[90] *Id*. at 1680.

[91] It blamed "the sensationalistic media," the organization of parents, and "the unique destructive force of personal-injury lawyers" for creating the Program and allowing it to perpetuate "the myth of pertussis vaccine encephalopathy." The editorial's author came under scrutiny by ABC News. He was accused of bias for failing to disclose in the editorial or to JAMA consulting fees and grants he and his university had received from Lederle Laboratories, which manufactures pertussis vaccine. Most recently, attorneys for some petitioners under the Program have claimed that the editorial was an attempt to mislead physicians and the public by discounting the real risks of pertussis vaccine.

[92] The committee has also felt the heat of controversy; at least one member resigned after a public challenge was raised as to his objectivity.

The majority of Program Office objections to petitions filed under the Program have been made in cases involving pertussis vaccine (77.6 percent). However, most awards of compensation (82.2 percent) have been granted in cases involving pertussis vaccine. If the Vaccine Injury Table were amended to exclude encephalopathy following pertussis vaccination, the Program might collapse. Such a change in the Table would undoubtedly provoke the strong opposition of many parents. That opposition might be sufficient to block any change in the Table. If so, one might expect Program Office physicians and many pediatricians associated with HHS to object and obstruct the Program's operation in pertussis cases.

The Program could become quite small if pertussis vaccine encephalopathy (or any adverse reaction to pertussis listed in the Table) were excluded as a compensable injury; many of the pertussis petitions would be excluded. On the other hand, the Program might get bogged down with efforts by petitioners to prove that their children's encephalopathy was caused by the vaccine, regardless of its omission from the Table. Parents and their attorneys might withdraw their support of the Program as a whole, and press their claims more vigorously in independent tort litigation. It is doubtful that the vaccine manufacturing industry would welcome a resurgence of litigation, unless it found the surtax attributable to pertussis cases under the Program especially onerous and it believed that it could defend lawsuits more cheaply. Thus, the controversy that in large part gave birth to the Program may resurface as the Program's greatest challenge.

In the absence of conclusive new evidence that a condition listed in the Table is not an adverse reaction to a covered vaccine, it would be difficult to remove a Table injury without jeopardizing the efficient continuation of the Program itself. Existing scientific studies indicating the probability of specific adverse reactions to pertussis vaccine have not quelled disagreement on either the nature or incidence of particular reactions.[93] The Vaccine Injury Table serves a critical function because it was intended to keep unresolvable disputes from affecting eligibility for compensation. It represents a policy choice made by Congress. As long as disputes over causation remain unresolved, that policy choice retains its justification and utility.

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[93] Disagreements even manifest themselves in efforts by the Advisory Commission on Childhood Vaccine to prepare informational materials for parents whose children are offered vaccination. The definitions of benefits and risks of pertussis vaccine and the emphasis given each has been hotly debated by members and invited experts.

## Practical Difficulties in Applying the Table

The primary merit of the Vaccine Injury Table lies in its elimination of disputes over the cause of injuries. However, applying the Table in individual cases has been more difficult then might have been expected. One reason was the apparent misunderstanding of the Table's function, discussed above. This kind of problem is not inherent in either the use of the Table or the Program itself and can be erased as Program participants better appreciate that the Table lists compensable injuries, not suggested examples of causation-in-fact.

A second, more difficult problem lies in interpreting the Table in individual cases. An example is the characterization of death following vaccination with a covered vaccine. The Act clearly contemplates death as a compensable injury and petitioners generally assume that it is a Table injury. However, the Vaccine Injury Table lists death only as an acute complication of other specifically listed conditions, such as anaphylaxis or shock-collapse. Thus, in cases in which a child died following vaccination, but there is no evidence of symptoms of another listed medical condition before death, the petitioner has assumed that the death qualifies as a Table injury, while the Program Office has frequently attributed the death to Sudden Infant Death Syndrome (SIDS), arguing that it does not qualify as a Table injury. Thus, the issue of causation-in-fact has intruded in a significant number of cases that Congress may have expected to be simple Table cases. While the Claims Court has awarded compensation in more than three times as many cases as the Program Office thought eligible, the necessity of resolving such disputes has slowed the decisionmaking process.

A third practical problem is that of proving that a Table injury occurred. The critical condition for establishing entitlement to compensation is that the injured person sustained, or had significantly aggravated, an injury or death listed in the Table within the time period specified in the Table. There is no doubt that the petitioner bears the burden of proof on this issue.[94] But the type of proof required to satisfy petitioner's burden remains problematic.

The most difficult cases often concern immunization with DTP. The Program Office has objected to more than 77 percent of petitions listing injury or death following vaccination with DTP vaccine, often on the ground that petitioner's evidence does not demonstrate that encephalopathy, hypotonic collapse, or other Table injury was the condition diagnosed shortly after vaccination. For example, in one case, the petitioner submitted an electroencephalogram (EEG) indicating neurologic abnormalities in support of a claim that a child had encephalopathy. The DOJ, on behalf of the Program Office, objected that "an abnormal EEG is not conclusive of an encephalopathy."[95] The Claims Court judge noted that the Act's aids to interpretation included a statement that "Encephalopathy can usually be documented by slow wave activity on an electroencephalogram."[96] Nonetheless, the Court required additional medical testimony on this issue because, in the absence of expert medical testimony, it did not consider itself able to decide whether the child in question suffered an encephalopathy as defined in the Act within the required time period.[97] Such decisions encourage presenting more extensive medical evidence to demonstrate a clear diagnosis.

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[94] 42 U.S.C. 300aa-13(a)(1)(A).

The question remains whether the petitioner must present evidence of a physician's definitive diagnosis (of encephalopathy or other injury), or whether any kind of evidence of a condition described in the Table should satisfy the petitioner's burden of proof. The Program Office generally takes the former position, while petitioners, for the most part, take the latter. Most final judgments issued by the Court have adopted the latter position, although rarely explicitly. The Act specifies that the court may not find that the petitioner has satisfied his burden of proof "based on the claims of a petitioner alone, unsubstantiated by medical records or by medical opinion."[98] But it does not require that the medical opinion be contemporaneous with the injury. Some petitioners who are unable to produce medical records of a child's evaluation and treatment at the time of injury must themselves describe the child's behavior and condition. Then, to place the condition within the Table, they may offer medical testimony that the condition the parents describe indicates a Table injury. This approach would satisfy the requirements of the Act read literally, since the section calls for substantiation by "medical records **or** medical opinion" (emphasis added).[99] But medical opinion as to the meaning of symptoms or behavior that the physician has not personally verified is not always persuasive to the Program Office. Thus, proof (that a Table injury occurred) becomes a contested issue in a substantial number of cases.

Finally, there is the problem of determining whether an individual injury has been caused by something other than a vaccine, even if the injury clearly fits the Table. Section 13(a)(1) of the Act provides:[100]

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[95] Shaw v. Secretary, 18 Cl. Ct. 646, 650 (1989).

[96] *Id.*, citing 42 U.S.C. 300aa-14(b)(3)(A).

[97] *Id.*

[98] 42 U.S.C. 300aa-13(a)(1).

[99] It is also consistent with a related subsection that permits the special master or court to find that an injury occurred within the *time* prescribed in the Table, even if symptoms were not recorded or were inaccurately recorded, as long as there is a preponderance of the evidence that the injury did in fact occur within the Table's prescribed period. 42 U.S.C. 300aa-13(b)(2).

[100] 42 U.S.C. 300aa-13(a)(1).

> (1) Compensation shall be awarded under the Program to a petitioner if the special master or court finds on the record as a whole--
>
>> (A) that the petitioner has demonstrated by a preponderance of the evidence the matters required in the petition by section 2111(c)(1) [300aa-11 (c)(1)], and
>>
>> (B) that there is not a preponderance of the evidence that the illness, disability, injury, condition, or death described in the petition is due to factors unrelated to the administration of the vaccine described in the petition.

Some difficulty has surrounded the question of who, if anyone, bears the burden of producing evidence that the injury is "due to factors unrelated to the administration of the vaccine." The Act does not assign any burden of proof of unrelated cause to anyone.[101] Instead, subsection 13(a)(1), quoted above, requires the special master or court to find "on the record as a whole" that it is not more likely than not that the injury was caused by an unrelated factor.

It is not entirely surprising that the Act does not specify responsibility for proving unrelated cause. Once it was decided to have two parties to a proceeding--the petitioner, and the Secretary as respondent--it may have been assumed that the respondent would function as a defendant-respondent in a civil action and produce evidence to rebut the petitioner's claim in doubtful cases. At the same time, it is unlikely that Congress expected the Program to receive many claims that were caused by factors unrelated to the vaccine. Congress wished to screen out of the Program cases that were patently caused by something other than a vaccine. But there is no reason to believe that Congress expected or desired an intensive investigation of causation akin to that conducted by civil defendants.[102] The Program's structure was crafted to avoid just such proceedings. Congress may have expected any evidence of a cause of injury unrelated to vaccination to appear in the petitioner's documentation of injury. If so, it may have assumed that the special master or judge could consider this evidence and identify ineligible injuries.

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[101] The Act refers to the court's finding "upon demonstration by a preponderance of the evidence" that an injury did not fit the Table, because of onset outside the time period, 42 U.S.C 300aa--13(a)(2), but does not specify the source of the evidence.

[102] In the case of encephalopathy, the Act's aids to interpretation provide that if it is not possible to determine the cause of an encephalopathy by a preponderance of the evidence, it will be presumed to be a Table injury. 42 U.S.C. 300aa--14(b)(3)(B).

While the burden of proof of any unrelated cause is not specified in the Act, the burden of decision rests squarely with the special master, and, in early cases, with the Claims Court. The special masters have felt compelled by subsection 13(a)(1)(A) to make a finding of fact with respect to the presence or absence of an unrelated cause of injury. Some have been reluctant to do so in cases in which the Program Office has not taken a position.

In several cases, the Claims Court has stated that once a petitioner establishes a rebuttable presumption of causation, the burden shifts to respondent to show that the injury is due to unrelated factors.[103] Other cases have implicitly imposed the same burden by indicating that it is up to respondent to rebut a presumption of causation.[104]

The Program Office feels an obligation to present the special masters with any relevant arguments favoring an unrelated cause of injury. This falls somewhat short of formally assuming a burden of proving an unrelated cause, although the difference is not always apparent. This leads the Program Office to search the petitioner's evidence for indications of disease etiology independent of vaccination and to offer alternative explanations for the injury based on epidemiological studies.

The special master's role would be simplified if the Act placed on the respondent the burden of proving an unrelated cause of injury. In any case in which the respondent did not produce a preponderance of evidence (including evidence submitted by the petitioner) that an unrelated factor actually caused the injury, the special master could avoid weighing the evidence and award compensation on the ground that the respondent had failed to meet its burden of proof. Under existing circumstances, few special master feel that this option is open to them.[105] Instead, they must consider all the evidence and the often conflicting interpretations of the same evidence; they must find **both** a preponderance of evidence supporting petitioner's eligibility **and** no preponderance of evidence that the injury was caused by an unrelated factor.

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[103] Bell v. Secretary, 18 Cl. Ct. 751, 756 (1989); Ciotoli v. Secretary, 18 Cl. Ct. 576, 588 (1989).

[104] Dunham v. Secretary, 18 Cl. Ct. 633, 640 (1989).

[105] Several judges have found: "A successful showing of legal causation or causation in fact does not entitle petitioners to compensation. The court must still determine that the preponderance of evidence does not show an alternative cause for the injury." Shaw v. Secretary, 18 Cl. Ct. 646, 651 (1989).

## Conclusions

The most promising innovation made by the Program--the Vaccine Injury Table--has also proved to be one of the most controversial. Some of the controversy has historical roots in the debate over the kind and incidence of adverse reactions to covered vaccines. Some who believe that the Table includes conditions that are not caused by vaccines find it difficult to accept the Table's list as a substitute for causation-in-fact. But others, whether they agree or disagree with specific conditions listed in the Table, endorse the policy decision to eliminate causation as an issue for dispute in as many cases as possible. Thus, the utility of the Table has been widely accepted. To the extent that there are disagreements, they focus on the justifications for including one or more specific conditions in the Table. These kind of disagreements can be worked out within the Program's existing structure as long as it is accepted that the Table need not reflect indisputable proof of causation-in-fact but the desirability of settling a complicated problem.

As useful as the Table has been, it has not eliminated all problems of proving entitlement to compensation based upon a compensable injury. Although the Program permits petitioners to prove that a nonTable injury was in fact caused by a covered vaccine, most causation disputes have arisen in Table injury cases. Some of the disputes seem attributable to the inherent difficulties of proving that the injury was described in the Table and occurred within the requisite time period. Medical facts are not always obvious. Cases are not as easy as might have been expected. Different interpretations of some medical evidence seem inevitable, in retrospect. A list of compensable injuries will not avoid all disagreement over whether an individual's injury is described in the Table.

At the same time, the surprisingly high proportion of disputed cases suggests that some disagreement may have been unnecessary. In particular, the Program Office's objection to many Table injury cases, later found compensable by the Claims Court, on the theory that there might be an unrelated cause of injury appears to have been unfortunate. The time and energy required to locate and analyze nonobvious sources of information that might bear upon the actual cause of injury created an unnecessary burden on petitioners where there was no indication of any unrelated cause. The Table was made part of the Program to ensure speedy decisions. Protracted disputes over causation undermines the Program's efficiency and its ability to achieve its purposes.

# Chapter IV. Programmatic Structure and Administrative Innovation

Perhaps the most notable and innovative aspect of the Program is its programmatic structure. The nature and purpose of the Program might seem more readily suited to a simple benefit determination system administered by an agency within the federal executive branch. Since the Program sought to provide compensation for injuries on a no-fault basis, the major decisions affecting entitlement involve the cause of the injury, the nature of the resulting disability or death, and the amount of compensation needed to provide care for a permanently injured person. The first two factors turn on medical and scientific information; the third on medical and financial predictions. These are primarily questions of fact within the realm of expertise of administrative agencies like the Social Security Administration and the Health Care Financing Administration which administers Medicare and Medicaid.

The Program, however, uses the United States Claims Court and its special masters to make decisions respecting eligibility and compensation. While the Program Office reviews claims for compensation and presents its opinions to the Court, it does not act as decisionmaker for the Program. Although the Secretary of Health and Human Services may amend the Vaccine Injury Table by regulation, he is not authorized to issue regulations governing the decisionmaking process or interpreting the statute generally. The decisionmaking process is more similar to litigation or arbitration than to administration. Indeed, it operates most like an administrative tribunal.

## The Court or Special Master as Decisionmaker

The decision to vest jurisdiction for the resolution of claims with a court rather than a federal agency (or parallel state agencies) was primarily an effort to win the support of parents of children with vaccine-related injuries for the Act. Many parents placed little faith in the Department of Health and Human Services--the most obvious choice for a purely administrative program--because the agencies it oversaw, such as the Public Health Service and the Centers for Disease Control, were heavily involved in childhood immunization programs, and were seen as unsympathetic to compensating vaccine-related injuries.[106] Moreover, the Reagan administration opposed the adoption of the Program and made its opposition clear to the Department. The judicial system, on the other hand, was viewed by most parents as a more objective arbiter of vaccine injury claims, even though many courts had not permitted certain causes of action to be pursued on behalf of those with vaccine-related injuries.[107]

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[106] *See* text accompanying notes 14-15.

The Act as initially drafted and adopted in 1986 granted jurisdiction to the United States district courts to determine claims under the Program.[108] That court, however, was concerned with the possibility of having to handle a large number of new cases at a time when it had a full caseload. Some casting about for alternatives yielded the United States Claims Court, which was familiar with handling claims against the federal government. The Claims Court successfully sought additional resources to enable it to take on the anticipated cases and became the decisionmaker for claims under the Program. The Act was amended to reflect this change in 1987.[109]

The United States Claims Court was created by an Act of Congress in 1982 to succeed the Court of Claims.[110] Like its predecessor, the Claims Court has jurisdiction over monetary claims against the United States founded upon the Constitution, an act of Congress, an Executive Order, a regulation of an Executive Department, or a contract, express or implied-in-fact, with the United States.[111] Since an act of Congress authorizes the Secretary of Health and Human Services to make payments from the federal Trust Fund to eligible petitioners, the Claims Court is a comfortable choice for determining claims of entitlement to compensation. It also carried the advantage of national jurisdiction that permits one court to handle cases regardless of the residence of claimants.[112]

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[107] *See, e.g.* Brown v. Superior Court of San Francisco, 44 Cal. 3d 1049, 245 Cal. Rptr. 412, 751 p. 2d 470 (1988).

[108] 42 U.S.C. 300aa-11(a)(1) (1987).

[109] Pub. L. No. 100-203, Title IV, Subtitle D, 101 Stat. 1330-221 (December 22, 1987).

[110] Federal Courts Improvement Act, Pub. L. No. 97-164, sec. 105(a), 96 Stat. 27, 28 (1982). For a brief description of the court, its history, and jurisdiction, see United States Claims Court Bar Association, THE UNITED STATES CLAIMS COURT: A DESKBOOK FOR PRACTITIONERS (1987).

[111] 28 U.S.C. 1502 (1982). The federal Statute specifying the major spheres of jurisdiction of the Claims Court is known as the "Tucker Act," 28 U.S.C. 1491 (1982). Claims against the United States commonly heard by the Claims Court under the Tucker Act include eminent domain cases claiming compensation for the taking of private property for a public purpose pursuant to the Fifth Amendment to the Constitution; suits for federal tax refunds pursuant to the Internal Revenue Code and IRS regulations; suits by federal government employees or military personnel for back pay for unlawful termination of employment; and suits to obtain compensation for the use by the federal government of patents or copyrights. The Claims Court is also granted specific jurisdiction to hear other types of claims under particular statutes. However, except where specifically authorized by statute, it may not grant declaratory judgments nor issue equitable relief. With few exceptions, the Claims Court may only hear claims for money against the United States. The Claims Court has 16 judges who are appointed by the President and confirmed by the Senate. A Chief Judge, currently Loren A. Smith, is designated by the President. 28 U.S.C. 171 (1982).

Within the court, a new group of special masters created expressly for the Program is responsible for handling petitions. This specialized unit was unusual when originally established because the special masters heard only Program cases. As a result of the Technical Amendments, it has become unique in possessing final decisionmaking authority on all Program petitions filed since January 19, 1990.

Siting the decisionmaking process in an existing court makes the Program's structure quite distinct. It has the advantage of placing decisionmaking in the hands of persons who are truly disinterested in the outcomes of the claims they decide. The judges and special masters have not been involved in any medical or scientific controversy surrounding the existence or frequency of adverse reactions to vaccines. At the same time, this impartiality can be seen as disadvantageous by those who believe that some expertise in immunizations is necessary to understand the issues to be resolved.

The use of a court to make Program determinations has also created some difficulties in implementing the informal, expedited process envisioned by Congress. The difficulties may be attributable in part to the statutory structure established by the Act, in part to the organization and structure of courts as an institution, and partly to the decisionmaking needs of the Program.

The Act essentially grafted an administrative benefit system onto a judicial institution. While the Program was to be, and now is, a largely self-contained unit housed within the Claims Court, it was also subject to the internal administrative control of the judiciary. This meant that the Program would function within what anthropologists might call the culture of the courthouse. While there are both advantages and disadvantages to such a culture, it generated some consternation both at the Program Office and in Congress in the Program's earliest days.

## The Vaccine Rules

A significant example of this controversy was the Vaccine Rules. One of the first administrative actions taken by the Court was the adoption of rules to govern Program determinations. While the Act specified requirements for eligibility for compensation in great detail, it did not prescribe the internal procedures for filing and reviewing petitions, proving eligibility, or determining amounts of compensation. This hardly made the Act different from other legislation creating new programs. There is necessarily a gap between the general programmatic structure that the legislature can draft and the day-to-day actions that the Program participants must perform to operate it. The rules were an attempt to fill this gap. After the Program became effective in late 1988, the Court began drafting rules. After modifying the draft in response to comments on the proposed rules, the first Vaccine Rules were adopted by the Claims Court on January 25, 1989.[113] Four special masters, including the chief special master, were then in a position to begin to consider petitions that had been filed since October 1, 1988.

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[112] The Claims Court is located in Washington, DC Claims Court judges may travel to any location to hear cases for the convenience of the parties.

What troubled critics of the Rules was their similarity to the detailed rules of practice before the Claims Court, which, like the rules of most courts, are familiar to practicing lawyers and incomprehensible to most laypersons.[114] The Claims Court rules of practice prescribed such things as the time for filing pleadings and other papers, how service is made on parties to an action, the form of motions, procedures for discovery, conducting hearings, presenting evidence, entering judgments, and writing briefs. Such rules are intended to help attorneys present their cases efficiently to the Court. The Vaccine Rules followed this format for the sake of consistency. They were intended to help attorneys, especially since no one could be very familiar with the new Program and it was expected that few attorneys for petitioners would have practiced before the Claims Court or be familiar with its particular rules practice. In large part, they reproduced the general Claims Court Rules for use in the Program.

The Vaccine Rules, however, dismayed some in Congress who thought their technical legal nature inconsistent with the Act's mandate for informality in the Program. In particular, specific rules for conducting discovery and hearings, including the presentation of testimony, seemed more appropriate for traditional adversary litigation than for a Program designed to decide claims expeditiously. There was also concern that petitioners would be unable to enter the Program without the assistance of an attorney, because only attorneys could understand and comply with the Rules. While the Act clearly contemplated that petitioners might be represented by counsel, many feared that such representation coupled with traditional court rules could delay proceedings and make them overly adversarial. Interestingly, however, complaints about the Rules' formality or technicality came primarily from Congress and the Program Office, not from petitioners or their attorneys. The Vaccine Rules were ultimately revised and reissued in simpler form[115] in response to such concerns. The revision was undertaken by the Office of Special Masters after it had become the Program's decisionmaking unit as a result of the Technical Amendments. By then, experience with several vaccine petitions helped to clarify the kinds of rules that might serve the Program. Perhaps more importantly, as a separate unit, the special masters felt themselves free of any constraint experienced by the judges to adhere to the Federal Rules of Civil Procedure and Evidence. They considered themselves free to adopt informal measures to develop the record and hear evidence.

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[113] Vaccine Rules, General Order No. 23, United States Claims Court, January 25, 1989.

[114] The Claims Court is bound to follow the federal rules of evidence and procedure.

[115] Vaccine Rules, General Order No. 26, United States Claims Court, January 18, 1990, in Appendix J to the Rules of the United States Claims Court.

## Hearings and Informality in Decisionmaking

The most important decision to be made in the Program is, of course, whether a petitioner is eligible for compensation. The Act makes eligibility turn on six factors: the type of the vaccine; the nature of the injury, when it occurred, and whether it is listed in the Vaccine Injury Table or, if not, whether it was caused by a covered vaccine; the person's residence or citizenship; whether a person has received compensation for the same injury; whether the injury generated more than $1,000 in unreimbursable expenses; and whether the injury or death resulted from another cause.[116] The Act also requires the special master to make a determination on eligibility. On what basis is the determination to be made?

Petitioners have the burden of proving the first five eligibility requirements by a preponderance of the evidence.[117] Thus, the special master must base a determination on a review of the evidence. It is possible that Congress originally intended the special master to do this acting alone like an administrative decisionmaker. Before the Act was drafted in final form, it envisioned an *ex parte* proceeding in which the petitioner merely submitted a claim to the Program for decision. No other parties--not the vaccine manufacturer, the person who administered the vaccine, or the government--were to become parties to the process. Ultimately, however, the Act created a two-party proceeding with the Secretary as respondent. Thus, the Program became a variant on a civil action. The petitioner is required to prove eligibility and damages. The respondent may object to any such proof or its weight. Although some may have expected the Program Office to submit expert opinion as the nominal respondent without being a real party in interest, its statutory designation makes it a real adversary in the Program's structure.
The Act treats the special master like a judge, not like an administrative medical reviewer. The quasi-judicial role of the special master led to some

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[116] 42 U.S.C. 300aa-11(c)(1).

[117] 42 U.S.C. 300aa-13(a)(1)(A).

misunderstanding in the first few months of the Program's operation. The Act required the special master to base a decision on a preponderance of the evidence substantiated by medical records or by medical opinion.[118] Special masters could not decide cases based on their own knowledge. But they knew how to review evidence presented by parties to litigation. In an effort to ensure impartial decisionmaking, they relied primarily on trial-type procedures to elicit a fair and complete airing of the evidence. For most, this included a hearing on the evidence. The hearing entailed having the petitioner or the petitioner's attorney present the evidence supporting eligibility, including medical records and expert testimony on the date and nature of the injury. The physician who reviewed the petition on behalf of the Program Office was also expected to offer expert opinion on the cause of the injury. The actions of special masters in setting rules about what kind of documents could be introduced as authentic, and who should speak when, and encouraging cross-examination of experts looked to many like an effort to hold a mini-trial.[119]

As a practical matter, it is hard to fault the special masters for their reliance on hearings. If evidence is to be presented, there must be a place for the parties to do so. If the evidence is to be considered critically by the special master, it must be subject to some kind of testing for relevance and accuracy. The special masters had no factual basis for critiquing the evidence themselves, at least during the first months of the Program when they confronted vaccine-related issues for the first time. It should not be surprising, therefore, that they asked counsel for the parties, who were familiar with the issues, to pose questions to their own and opposing experts to elicit an adequate analysis of the evidence to permit a reasoned decision. This process, however, looked too much like cross-examination in a trial to fit within the informality mandate for the Program. Petitioners' counsel often viewed Program office physicians as expert witnesses for the respondent and cross-examined them vigorously both as to their expertise and their opinions. It disturbed Program Office physicians who had no experience with litigation and, not being adequately informed of its purpose, made them feel they were targets of an inquisition instead of the independent experts they thought they were. This tension apparently reinforced the feeling that the Program Office, as well as petitioners, needed representation by counsel. Attorneys from the Department of Justice were expected both to protect Program Office staff and to communicate with the special masters in their own language.

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[118] 42 U.S.C. 300aa-13(a)(1).

[119] Special masters wore judicial robes when holding such hearings. The court believed that the parties were entitled to feel that the petition was being taken seriously by an impartial decisionmaker and that the robes were a sign of respect for the Program. Others viewed the use of robes as overly judicial and the special masters abandoned the practice in deference to the concern. Although a trivial issue, it illustrates the degree of sensitivity that existed over the formality appropriate to the Program.

Some members of Congress took particular exception to the litigation appearance of hearings.[120] When the Program began to get stymied in the summer of 1989, Congress agreed to consider amending the Act to get rid of formalistic procedures. The Technical Amendments of 1989 specifically required the adoption of new rules that would "provide for a less adversarial, expeditious, and informal proceeding for the resolution of petitions," "include flexible and informal standards of admissibility of evidence," limit discovery, and include opportunities to submit arguments and evidence without cross examination or hearings.[121]

The hearing problem has been largely settled by a modified hearing format with less reliance on formal rules of presentation. It qualifies as a hearing largely because it is an opportunity for all parties to hear each other, present evidence, and pose questions. That is the essence of a hearing. The formality has been diluted and the hearing made more congenial by the special masters' addition of one or more status conferences in which the parties or, ordinarily, their attorneys, meet with the special master to identify areas of agreement and dispute.[122] This is consistent with trial practice, but the actual conferences have a more casual feeling than most pretrial conferences.

The most interesting adaptation of the pretrial conference is the Rule 5 Conference, devised to expedite decisionmaking. Under Vaccine Rule 5, the special master may meet with the parties (usually just the parties' counsel, in person or by telephone) to clarify points of agreement and dispute. Because all of petitioner's documentation and respondent's reports must be submitted before the meeting, it is an excellent opportunity to test the merits of a case. Deficiencies can be identified and often remedied early enough to meet the statutory deadline for decisions. Each party can explain its position and question the other party to narrow the points actually in dispute. Not infrequently, the discussions lead to settlement. Most important, the special master may offer a tentative, nonbinding reaction to the arguments and how it appears the case should be decided. In some instances, a final decision emerges rapidly from a Rule 5 Conference. In others, additional proceedings can be arranged conveniently and expeditiously. The off-the-record atmosphere is valuable in producing an honest and critical appraisal of a case and moving it quickly to resolution.

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[120] The Conference Report on the Technical Amendments noted,

"The Conferees have received reports that the current rules of the court are formal rules akin to those of the Federal courts for civil litigation. The Conferees once more reiterate their desire that the vaccine proceedings be made as swift and uncomplicated as possible." Omnibus Budget Reconciliation Act of 1989, Conference Report to accompany H.R. 3299, at 515 (Nov. 21, 1989). The Report also stated their concern that the authority given to the special master "not be used to re-create an adversarial process...." *Id.* at 516.

[121] 42 U.S.C. 300aa-12(d)(2).

[122] The parties are also allowed and encouraged to reach agreement themselves both on eligibility and amounts of compensation, that is, to "settle" the case.

Another interesting innovation, instituted early in the Program, is the conduct of hearings and conferences by telephone. All special masters now conduct some hearings by telephone conference call with attorneys for the parties and witnesses all on the line. This procedure enhances the Program's efficiency. Since experts who may testify may come from a different state than the petitioner, and some attorneys represent petitioners outside their own state of practice, it is often difficult and expensive to bring all the necessary people together in one place. Telephonic hearings eliminate the travel time and expense, as well as problems finding a date convenient for all. These hearings are growing in popularity and use. Most special masters began to use them after having met the parties--or at least the petitioner's attorney--and having heard the experts (usually in an earlier case)--in person. Having had an opportunity to assess a witness' credibility in person, they were comfortable receiving oral testimony over the telephone.

The national jurisdiction of the Claims Court made the use of telephone conferences both possible and popular. In addition, it enables the special masters to travel to other locations to conduct conferences and hearings in person. This saves petitioners considerable time and expense. Although the Claims Court pays for the travel of the special master and the government for a DOJ attorney and sometimes Program Office expert to travel, the total number of persons traveling is usually smaller than would be necessary to bring everyone to Washington, DC.[123] Thus, the net outlay is lower. The Program saves money because it ordinarily pays the travel fees incurred by and on behalf of petitioners as part of attorneys' fees and other costs. These and other procedures have been summarized recently in *Guidelines for Practice* issued by the Office of Special Masters in April 1990.[124] The *Guidelines* supplement the Vaccine Rules by explaining the general conduct of Program proceedings, emphasizing the flexibility of the procedures available in the spirit of a renewed commitment to the informality mandate.

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[123] Moreover, the program Office and/or DOJ attorneys sometimes appear by telephone in Washington, DC hearings.

[124] Office of the Special Masters, U.S. Claims Court, GUIDELINES FOR PRACTICE UNDER THE NATIONAL VACCINE INJURY COMPENSATION PROGRAM, April 1990 (available from the U.S. Claims Court).

## Front-End Loading

Another innovation created by the Program is the requirement that all evidence supporting eligibility for compensation be submitted at the time the petition is filed. This is known as "front-end loading." The Act initially permitted a petition to be filed with "supporting documentation" of eligibility.[125] The Program Office was frequently of the opinion that many materials relevant to determining eligibility were omitted. Petitioners sometimes disagreed. Considerable time was spent in discovery trying to identify and obtain additional medical and other records before a petition would be reviewed, or in resolving disputes about just what documentation was necessary.

The Technical Amendments clarified the kinds of documentation that must be submitted with the petition.[126] This reduced the opportunities for dispute and simplified assessments of whether a petition was complete. Identifying and collecting the documentation before a petition is filed, however, may delay the commencement of review.[127] Thus, front-end loading may merely shift the document collection time period from after filing to before filing a petition. In cases in which a potential petitioner learns of possible eligibility to enter the Program shortly before the statute of limitations expires, it may be difficult or impossible to produce an acceptable petition by the filing deadline.

## Calculating Compensation

While the issue of eligibility for compensation has been the focus of the greatest conceptual dispute, determining the amount of compensation payable to eligible petitioners has been more time-consuming than might have been predicted. The Act says very little about how to calculate compensation.[128] It does specify that medical expenses be those that are actually incurred[129]--both before and after the final judgment in prospective cases, but only after judgment in retrospective cases. But since the award must be made before future expenses are incurred, an estimate is needed.

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[125] 42 U.S.C. 300aa-11(c)(1987).

[126] Petitioners must attach to a petition "maternal prenatal and delivery records, newborn hospital records..., vaccination records..., pre and post-injury physician and clinic records..., all post-injury inpatient and outpatient records..., if applicable, a death certificate, and, if applicable, autopsy results...," and identify records that are not available and the reasons for their unavailability. 42 U.S.C. 300aa-11(c)(2),(3). These were the records that the Program Office stated they would "view as necessary" to conduct its review in an advice to the public, published in the Federal Register, 53 Fed. Reg. 49360, on December 7, 1988.

[127] Several petitioners attorneys estimated that, in ordinary circumstances, at least 2 months would be required to obtain medical records from physicians, clinics, and hospitals.

[128] *See* text accompanying note 51.

To estimate future expenses of caring for a disabled child, petitioners have used the testimony of economists, actuaries, and case managers. Special masters have held separate conferences or hearings to consider compensation awards. Settlement of compensation amounts has proved difficult in many cases. Petitioners and DOJ attorneys may have different expectations of appropriate amounts.[130] Thus, hearings must often be held on the kinds of therapy, rehabilitation, and other care that will be needed and for how long and at what cost, exclusive of possible insurance and other benefits. In the absence of statutory measures, such as inflation or discount rates to reduce future costs to present values, the parties may disagree not only as to the kind of expenses that are necessary, but also how to calculate their current value.

Many issues are quite narrow and technical. In one case, for example, the DOJ has challenged the inclusion of compensation to cover future taxes on interest earned on the invested compensation award as without basis in the statute. The Claims Court rejected the challenge. Noting that the Act calculates compensation "on the basis of the net present value of the compensation,"[131] the Court observed that net present value would reflect both future interest payments and drains on such interest, such as taxes.[132] Moreover, the Act requires that future earnings losses be reduced by expected income taxes as such earnings. Thus, it found it consistent to account for the tax effect as it reduces both future losses and future interest. Similarly, the Court rejected a DOJ contention that leisure equipment like swings did not qualify as equipment for therapy,[133] stating that the terms or labels used to describe otherwise appropriate rehabilitative equipment should not take precedence over substance. The Program Office also argued, unsuccessfully, that compensation should be offset by future Medicaid benefits on the theory that the child could qualify for Medicaid in the future.[134]

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[129] Expenses reimbursable to the petitioner are not incurred expenses. Compensation will not be awarded for benefits paid by any insurer, state compensation program, or federal or state health benefits program, except medicaid. 42 U.S.C. 300aa-15(g). The Technical Amendments added the medicaid exception to ensure that medicaid is not a primary payor.

[130] DOJ attorneys may also be hampered in some cases by limitations on the amounts they can authorize for payment to settle a petition. Settlements exceeding $750,000 must be approved by the Deputy Attorney General.

[131] 42 U.S.C. 300aa-15(f)(4)(A).

[132] Shaw v. Secretary, 18 Cl. Ct. 646, 654 (1989).

[133] Clark v. Secretary, 19 Cl. Ct. 113, 126-7 (1989).

Resolution of these kinds of issues is time consuming and, if financial and life care plan experts are used, expensive.[135] The time saved by the use of the Vaccine Injury Table may be lost in the determination of compensation awards. Of course, this problem is largely restricted to cases of injury and not death. But an increasing proportion of cases now being reviewed involve injury, partly because more death cases were decided earlier. Because injury cases generally involve severely disabled children who will require many years of care, the amounts at issue are high, often reaching above $1 million. Thus, the Program faces the likelihood of a growing number of hearings to decide significant amounts of compensation. Since these occur at the end of the decisionmaking process, protracted proceedings can jeopardize the program's ability to reach a final decision within statutory time limits. While it might be desirable to begin to consider compensation amounts earlier in the decisionmaking process, it could prove a waste of time and money for those cases in which the petitioner was found ineligible for compensation. An alternative might be to develop compensation schedules that could be applied, with some flexibility, more efficiently.

## Attorneys' Fees

The structure of the Program tends to encourage petitioners to be represented by counsel and to discourage proceeding *pro se*. Thus, the willingness of competent counsel to represent petitioners will affect the number of petitions filed and decided and, presumably, petitioners' general satisfaction with the Program's existence. The availability of attorneys' fees influences an attorney's ability and willingness to represent petitioners.[136] The Act's provisions governing attorneys' fees[137] gave rise to some initial confusion and may pose additional difficulties in the future.

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[134] Clark v. Secretary, 19 Cl. Ct. 113 (1989); Moorhead v. Secretary, 18 Cl. Ct. 849 (1989). The argument was rejected largely because the government had no evidence that the child could become eligible for Medicaid, even though the Secretary, as nominal respondent, had superior knowledge respecting eligibility.

[135] An extreme example is a hearing on the amount of compensation in one case that lasted 30 hours.

[136] Clark v. Secretary, 19 Cl. Ct. 113, 131 (1989) ("It is in the public's interest to encourage attorneys to accept vaccine injury cases by assuring a reasonable attorney fee.").

[137] 42 U.S.C. 300aa-15(b) & (e).

## The $30,000 Limit in Retrospective Cases

The initial controversy concerned the amount of attorneys' fees in retrospective cases. The Act limited the amount payable for attorneys' fees and costs, together with compensation for lost earnings and pain and suffering, to $30,000.[138] Some petitioners' attorneys and two special masters interpreted the statute to mean that the $30,000 limitation applied only to costs and attorneys' fees for services undertaken to establish lost earnings and pain and suffering,[139] so that fees and costs attributable to other services were not limited. This interpretation seems a bit strained, even considering the rather cumbersome wording of the statute, especially since there is little, if any, precedent for limiting attorneys' fees on the basis of the nature of damages for which services were performed. Those who drafted the legislation certainly meant to place the cap on the combined total of all four items.[140] Congress made its intent explicit in the Technical Amendments by rewriting section 15(b) to limit to $30,000 the sum of all attorneys' fees and costs, pain and suffering, and lost earnings in retrospective cases.[141]

It is unfortunate that time and resources had to be used to clarify the section. But the process of clarification did not damage the structure or operation of the Program. Careful analysis of statutory language to settle conflicting interpretations of available compensation seems inevitable in any new benefit program.

Some participants, however, are concerned that the $30,000 limit is still too low to permit representation in many cases. In cases in which the petitioner had instituted a civil court action for same injury before the Program began, substantial out-of-pocket costs and many attorney's hours may have been spent.[142] If these out-of-pocket costs and some compensation for legal services is not recoverable under the Program, there may be little incentive for an attorney to encourage filing with the Program rather than pursuing the civil action.[143] The $30,000 limit may have a more dramatic impact on cases that do not appear to fit the Table, because the evidence needed to prove that a covered vaccine caused the injury or death can be expensive. Even in Table injury cases, the Program Office significantly influences the documentation and expertise that should be presented and, with them, the time spent demonstrating eligibility for compensation.

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[138] 42 U.S.C. 300aa-15(b).

[139] *See* Hanagan v. Secretary, Report of the Special Master, 1989 U.S. Cl. Ct. Lexis 277; Clark v. Secretary, Report of the Special Master, 1989 U.S. Cl. Ct. Lexis 113; Shepherd v. Secretary, Report of the Special Master, 1990 U.S. Cl. Ct. Lexis 292; Shaw v. Secretary, Report of the Special Master, 1990 U.S. Cl. Ct. Lexis 258.

[140] *See* H.R. Rep. No. 391(I), 100th Cong. 1st Sess., 1987 U.S. Code Cong. & Admin. News 2313-1, 2313-371 to 2313-372. The majority of special masters and judges accepted this interpretation. A detailed explanation is set forth in Mikulich v. Secretary, 18 Cl. Ct. 253 (1989). *See*, Clark v. Secretary, 19 Cl. Ct. 113 (1989); Hanagan v. Secretary, 19 Cl. Ct. 7 (1989); Shepherd v. Secretary, 18 Cl. Ct. 774 (1989); Shaw v. Secretary, 18 Cl. Ct. 646 (1989); Matthews v. Secretary, 18 Cl. Ct. 514 (1989); Bazan v. Secretary, 18 Cl. Ct. 309 (1989). But, *see* Brown v. Secretary, 18 Cl. Ct. 834, 845 (1989).

[141] That section now provides: "Compensation awarded under the Program to a petitioner [in retrospective cases] may also include an amount, not to exceed a combined total of $30,000, for (1) lost earnings (as provided in paragraph (3) of subsection (a), (2) pain and suffering (as provided in paragraph (4) of subsection (a)), and (3) reasonable attorneys' fees and costs (as provided in subsection (e)."

Because these concerns apply only in retrospective cases, they will expire with the right to file retrospective petitions on October 1, 1990. Nevertheless, to the extent that attorneys' fee limits reduce access to the Program by potential petitioners, they may undermine public satisfaction with the Program. In addition, if Congress were to consider placing limits on attorneys' fees for prospective cases in the future, the same issues would resurface. Then it would be important to determine the actual reasonable costs of pursuing both Table and nonTable cases, and to compare those costs with the Trust Fund resources available.[144]

## Reasonable Attorneys' Fees

The question of what constitutes a reasonable attorney's fee will continue to confront prospective cases. While petitions concerning post-October 1, 1988 vaccinations will not have incurred prior litigation expenses, they will have no limitation on attorneys' fees and costs. Will the Program have developed acceptable rules of thumb for calculating reasonable attorneys' fees and costs? There is, of course, a substantial body of law governing the award of attorneys' fees in federal court actions and the Claims Court has drawn upon it in determining awards in retrospective cases.[145] But each case must be decided upon its own facts.

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[142] In one case, for example, an attorney estimated that $100,000 were spent in costs alone in prior litigation.

[143] The Act tries to encourage choosing the Program by permitting an award of past costs and expenses (including the reasonable value of time spent by attorney) in cases in which the petitioner dismissed a preOctober 1, 1988, civil action in order to enter the Program. 42 U.S.C. 300aa-15(e)(2). Eligible costs and time spent must have occurred before October 1, 1988. This subsection appears to permit such an award in addition to the award for attorneys' fees and costs under the Program because it does not specify that this award counts as part of the regular award authorized in subsection 300aa-15(e)(1). But the award does not appear to apply to civil actions that were lost by petitioner or settled without compensation before filing a petition with the Program. 42 U.S.C. 300aa-11(a)(4).

[144] One astute judge noted potential problems with the $30,000 statutory limit and observed that if "experience teaches us that a problem exists, it will be up to the Congress to formulate a solution." Clark v. Secretary, 19 Cl. Ct. 113, 128 (1989).

An alternative method would be to establish a fee schedule based on the type of injury, with or without adjustments for expertise, geographic location or other cost factors. A schedule has the advantage of predictability and speed of application, but lacks the flexibility ordinarily thought necessary in varied circumstances. Attorneys' fees awards in retrospective cases have spanned a wide range. The variation cannot be explained by whether or not the petitioner claimed a Table injury. It remains to be seen whether future cases will exhibit enough regularity to permit consistent fee awards.

The limitation on attorneys' fees in retrospective cases may have contributed to streamlining the Program's operation. With fee limits, attorneys may have spent less time on a case than they ordinarily might or moved it along more efficiently. There may be less incentive for efficiency in prospective cases unless a fee schedule is created or reasonable fee awards become predictable as a result of consistent Program decisions. The Program's ability to award fees and costs in good faith cases even if the petitioner is not entitled to compensation should help encourage attorneys to represent petitioners even if fee awards are relatively modest.

## Conclusions

The Program's programmatic structure represents an innovation in federal benefit programs. It is a hybrid organization composed of elements of a traditional administrative agency review system and traditional civil litigation proceedings for the resolution of disputes. It may be most comparable to an administrative tribunal. In spite of Congressional wishes that the process be nonadversarial, however, it is more like litigation than administrative review. Part of this is the result of the different expectations for the Program harbored by different participants. But most is attributable to the very programmatic structure created in the Act. Establishing petitioners and a respondent and putting the decisionmaking authority in a court virtually guaranteed that the process would simulate court procedures. The use of special masters and judges whose experience is limited primarily to litigation encourages their reliance on judicial procedures to ensure impartial results in cases whose facts they knew little about prior to the enactment of the Program. Nonetheless, an impartial decisionmaker is especially valuable in a program intended to address issues with a history of controversy. Moreover, the procedures have been adapted to suit a process that must be completed in a relatively brief amount of time. The Program offers an exciting alternative both to litigation and to administrative review. While the alternative has taken some getting used to, it is settling into place and gaining increasing acceptance with each month of operation.

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[145] The special masters and the Court have adopted the "lodestar" method described in Lolley v. Secretary, 88-33V, 99 W.L. 132196 (Cl. Ct. Oct. 18, 1989). *See*, *e.g.* Gregson v. Secretary, 17 Cl. Ct. 19 (1989); Ciotoli v. Secretary, 18 Cl. Ct. 576 (1989) This method calculates fees as the product of a reasonable number of hours multiplied by a reasonable hourly rate. Most cases have approved hourly rates of between $100 and 200 per hour, depending upon the attorney's place of business and expertise. However, at least two judges have limited fees to $75 per hour as in the Equal Access to Justice Act, largely for lack of reliable justification for a higher rate. Moorhead v. U.S., 18 Cl. Ct. 849, 853-4 (1989); Brown v. Secretary, 18 Cl. Ct. 834, 844 (1989).

# Chapter V. New Roles for Program Participants and the Technical Amendments

The new hybrid structure of the Program has assigned special functions to the special masters, judges, Program Office physicians, Department of Justice attorneys, and petitioners' attorneys. Some of these functions are specified in the Act; others have developed as responses to the need to create the administrative procedures necessary to implement the Program. Because the decisionmaking process employs petitioners, respondents, and a court, and is intended to provide a simple and efficient compensation mechanism, the participants have assumed hybrid roles suitable to the programmatic structure. Defining these new roles has been an iterative process requiring some creativity and patience, and is still ongoing. This chapter describes this process of role definition because it appears to be especially important to the efficient functioning of the Program itself.

## A Special Role for Special Masters

The role of the special masters of the U.S. Claims Court was rather unusual as initially set forth in the original Act and has been made even more so as a result of the Technical Amendments that became effective January 19, 1990. Under the original Act, the Claims Court had jurisdiction over proceedings to determine eligibility for compensation and the amount of compensation,[146] and special masters appointed by the Court were charged with the duty of reviewing the petition, hearing evidence,[147] and submitting to the Court proposed findings of fact and conclusions of law with respect to eligibility and compensation.[148] The special master was described in the original Act as an "adjunct to the court"[149] and functioned like most special masters in court proceedings. They were empowered to require the submission of evidence, including the production of documents and the testimony of witnesses, and to conduct hearings.[150] In theory, the special masters controlled the evidence to be submitted; the Act precluded discovery that was not "required" by the special master.[151] However, at the Program's start, it was difficult for the special masters to know what kind of information and evidence to "require." As a practical matter, discovery was proposed by the parties and authorized by the special master.

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[146] 42 U.S.C. 300aa-12(a) (1987).

[147] 42 U.S.C. 300aa-12(b)(2) (1987).

While the special masters supervised the factfinding and all procedures to make an initial determination both on eligibility for compensation and the amount of any award, their findings and conclusions had to be submitted to a Claims Court judge who was to issue the final judgment. The judge could accept or modify the special master's recommendation, hear the case de novo and issue a final judgment, or remand the case to the special master for additional factfinding or reconsideration of specific issues, with final review and judgment by the judge thereafter.[152]

In 1988, the Claims Court had estimated that with the Program budget allotted to it, it could hire eight special masters to handle Program claims. The Technical Amendments later limited the Program to eight special masters, to be appointed by the Claims Court judges for a term of 4 years, subject to removal either for cause or in the event that fewer special masters are needed.[153]

The most significant change made by the Technical Amendments was the grant of power to the special masters to make final judgments on eligibility and amounts of compensation.[154] This was intended to avoid unnecessary duplication of effort before a judge to reach a final judgment. No cases had been decided under these new rules by the end of February 1990, but the general attitude toward the new rules among many of those involved with the Program is positive.

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[148] 42 U.S.C. 300aa-12(c)(2) (1987).

[149] *Id.*

[150] *Id.*

[151] *Id.*

[152] 42 U.S.C. 300aa-12(d) (1987). This section permitted the court to accept the special master's recommendation without review if neither the petitioner nor the respondent objected to the recommendation. Still, the court had the power to review on its own initiative.

[153] 42 U.S.C. 300aa-12(c)(1). Because the Program received fewer petitions than originally expected during its first year, the Claims Court determined that it is not likely to continue to need the full complement of eight masters. One special master left in April 1990, another is planning to leave in July 1990, and a third may serve part-time for the immediate future. This will leave the Court with five and one half full-time special masters, including a Chief Special Master. Each is to serve a term of 4 years from the date of his or her original appointment in 1989.

A second significant and positive change made by the Technical Amendments was to describe the powers of special masters more explicitly. Indeed, it appears that the fact that special masters are granted considerable freedom to devise administrative procedures and move cases along is the most important benefit of the Amendments. This freedom enables them to act quickly and decisively in response to administrative needs. Their authority with respect to procedures for reviewing petitions, however, actually changed very little. Originally, they could require the submission of "appropriate" evidence and hold "appropriate" hearing, whereas the Technical Amendments describe the power to require such evidence and conduct such hearings "as may be reasonable and necessary," suggesting that Congress wanted to narrow the evidentiary search and formal proceedings as much as possible. But the difference between "appropriate" and "reasonable and necessary" is subtle at best, indicating perhaps that certain basic powers are necessary to a decisionmaker and that an enabling statute can express little more than the general grant of authority.

The Technical Amendments also specified the federal salary level for special masters (up to level V of the Executive Schedule, with the chief special master at level IV).[155] This greatly simplified the determination of such issues as rates of travel expense reimbursement and per diems for cases in which hearings were held outside Washington, DC. In the absence of such a designation, it had been unclear what rates should apply, and time was wasted determining eligibility and making hearing arrangements.

The Technical Amendments also required the special masters to recommend new Vaccine Rules for adoption by the Claims Court. The Amendments specified that the rules should "provide for a less-adversarial, expeditious, and informal proceeding," Since most of the procedures later included in the new Vaccine Rules were already being used by mid-1989, incorporating the requirements into the Act was mostly symbolic.

Interestingly, one change contemplated by Congress did not appear in the Technical Amendments. The Committee Report suggested that it would be desirable to appoint persons--including nonattorneys--with expertise in medicine and public health as special masters.[156] The Amendments do not state qualifications for serving as a special master, neither that one be an attorney nor that one have a medical background or not be an attorney. Although eligibility for compensation turns largely on medical evidence of a Table injury or one caused by a covered vaccine, the procedures used to identify relevant evidence are largely legal. In addition, the amounts necessary to compensate an injured petitioner within the terms of the Act turn on financial evidence. Decisions about whether such evidence meets the statutory requirements are basically legal decisions. Thus, it is not clear that a nonattorney would function more effectively than an attorney in the role of special master. The point may be moot for the time being. In view of the likelihood that no additional special masters will be hired during the next few years, it is not likely that nonattorneys will be appointed in the foreseeable future.

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[154] 42 U.S.C. 300aa-12(d).

[155] 42 U.S.C. 300aa-12(c)(5).

The special masters are unusual in that they serve only in Program proceedings and do not hear other types of cases. This enables them to develop some expertise in the subject matter and should contribute to a rising level of efficiency. Since special masters serve only a 4-year term, however, any turnover in individual special masters could dilute the advantage of expertise. It is possible that individuals may find 4 years concentrating on Program cases to be sufficient and opt to move to a different career path.

The special masters and judges have the most clearly defined roles to play in the Program. This is partly because their functions are specified in the statute, and partly because they serve as decisionmakers, a traditional role that has been altered only slightly to meet the informality mandate. Still, the special masters' role is not that of traditional special masters. Their powers have been called "inquisitorial," rather than judicial or administrative. But it is not clear what this means. The term suggests the power to examine witnesses and perhaps compel evidence. But the Act now specifies the evidence that petitioners must submit, so that the special masters can apply the Act without needing to call forth evidence of their own choosing. Thus, while the powers and duties of special masters have been clarified, they serve a hybrid function that continues to evolve.

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[156] "The Conferees would note their concern that special masters be well-advised on matters of health, medicine, and public health. No-fault vaccine compensation proceedings raise fewer legal issues than issues of medicine and masters need not be lawyers by training. Masters with health training and background should be considered for appointment and those without such training should be encouraged to seek independent experts to provide information." Conference Report No. 101-386, 101st Cong. 1st Sess. 509, 515.

## The Role of Counsel for Petitioners

Virtually all petitioners have been represented by counsel, if not by the time a petition is filed, then shortly thereafter. The Act clearly contemplates such representation by its explicit provision for the award of reasonable attorneys' fees and costs in good faith cases,[157] but does not require it. The structure of the Program, the proof required to establish eligibility, and the need to comply with the Vaccine Rules, however simplified, encourage petitioners to retain legal counsel to shepherd them through the proceedings.[158] In particular, the Act's requirement that the petitioner prove eligibility for compensation--rather than providing for a purely administrative determination--creates an incentive for petitioners to engage counsel who can collect and analyze evidence for presentation to a court.

The way in which attorneys should optimally function as representative of petitioners, however, remains unsettled. Extensive participation by litigators does raise questions about the fit between litigation skills and the Program's structure. The Program encourages attorneys to use their traditional litigation skills in presenting evidence to satisfy a petitioner's burden of proof. At the same time, it now requires amassing the petitioner's entire case and presenting it to the Court when the petition is filed. The "front-end loading" now specified in the Technical Amendments is not a traditional litigation technique.

In ordinary tort ligation, much of a plaintiff's attorney's time is spent trying to establish that a defendant acted wrongfully or that a product was defective and that this was the cause of the plaintiff's injury. These are the issues the Act intended to remove from dispute in the Program. In cases in which a petitioner claims eligibility for compensation by reason of an injury specified in the Table, there is no need to prove that a vaccine caused the injury. Rather, the proof relates to demonstrating that a particular injury or death described in the Table in fact occurred within the prescribed period of time. However, in cases in which the injury is not described in the Table, causation-in-fact must be proved, much as in traditional litigation. Since the existence of a Table injury has frequently been in dispute, litigation skills have been required more than might have been expected.

Still, the Program makes limited use of the skills in which litigators have comparative advantage over attorneys specializing in other areas. It requires litigators to adopt new modes of behavior and to adapt their skills to new uses. This has led a few participants to question whether litigation is the best specialty for an attorney representing a petitioner. They speculate that attorneys specializing in corporate representation or administrative law might be better prepared to present a full and complete petition and to engage in less formal discussions to reach a speedy decision. On the other hand, attorneys specializing in vaccine litigation are already familiar with the medical issues that may arise and how to present them,[159] and should be in a good position to counsel petitioners as to the risks and benefits of rejecting a Program decision in favor of pursuing litigation.

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[157] 42 U.S.C. 300aa-15(e).

[158] In the few cases in which petitioners filed with the Program *pro se*, the special master recommended that the petitioner retain independent counsel. This suggests that at least some special masters believe that petitioners may be unable to present their cases unaided by counsel.

A clearer definition of the precise role of petitioners' attorneys is beginning to emerge under the Program. Congress may find it frustrating to have attorneys insist on certain rules of evidence or cross-examination of witnesses because it is too reminiscent of litigation.[160] On the other hand, they are usually in the best position to point out strengths and weaknesses in a case. In any event, attorneys who are litigators are already adapting their behavior to suit a more casual decisionmaking process. Their apparent general satisfaction with the Program suggests that such adaptation will continue. If so, it suggests that the Program could serve as an alternative to litigation not only for petitioners but also for attorneys.

## New Roles for the Program Office and the Department of Justice

### The Program Office

The first section of the Act establishes a Program "to be administered by the Secretary."[161] The Secretary, through the Program Office, does administer the Trust Fund and makes payments of compensation awarded by the Program. However, decisionmaking authority is vested in the Claims Court, not the Program Office. The Act does not specify a typical administrative role for the Program Office. There is no authorization to promulgate regulations implementing or interpreting the statute. Instead, in the few references to its participation in the Program, the Act tends to treat the Secretary as the defendant in an action claiming money damages against the federal government.[162] To the extent that the Secretary is responsible for paying awards, this is, of course, entirely appropriate. However, the Act also reflects the ambiguous nature of the Program Office's role.

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[159] This may be seen in the relatively lesser number of hours vaccine litigators spend on cases compared with attorneys unfamiliar with vaccine issues.

[160] Such conduct can be displayed by any attorney, whether representing a petitioner or the respondent.

[161] 42 U.S.C. 300aa-10(a).

The Secretary was added to the Act as a respondent in a proceeding on a petition for compensation to provide an action in which opposing parties presented a case.[163] This was done to ensure that the proceeding would qualify as a "case or controversy" required for jurisdiction of the federal district courts under Article III of the Constitution. When the Act was amended to substitute the Claims Court, which is an Article I court, for the federal district courts, the original petitioner-respondent structure was not disturbed. Then, there was less concern over creating an image of a dispute suitable for judicial determination. Nonetheless, the mere designation of the Secretary as respondent in a claim for federal funds places the Program Office in the position of defending the government against the payment of awards that are not authorized by the Act.

At the same time, the Act does not require the Secretary to oppose petitions filed by persons seeking compensation. Indeed, the only explicit reference in the original Act to the Secretary's response to a petition allowed the Secretary, like the petitioner, to object to a special master's recommendation to the Claims Court, which triggered review of the decision by a Claims Court judge.[164]

The main task that the Program Office performs in practice--medical review of petitions--is not even mentioned expressly in the Act. It is certainly implied from receipt of the petition as respondent and from its power to object to a special master's decision on the petition. Nonetheless, the structure suggested by the Act is far from a purely administrative one. Rather, it mimics a civil action against the federal government.

The Program Office is organized along the lines of an administrative office for reviewing benefit claims. It is headed by a Director responsible for all its activities, and now has several administrative and secretarial staff.[165] The bulk of the work is devoted to reviewing petitions. This is done by staff physicians who act as medical reviewers. Until very recently, the Program Office was able to hire, at most, two full-time physicians. One, a pediatric neurologist, has been with the Program since its inception.[166] However, a second physician has not always been available, except on a part-time basis.

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[162] For example, a proceeding is commenced by "service upon the Secretary" as well as filing a petition with the Claims Court, in the same way that ordinary litigation is commenced by service of a complaint upon the defendant. 42 U.S.C. 300aa-11(a)(1). The Secretary must object to determinations and file appeals within specified time periods like any defendant in civil litigation.

[163] "The Secretary shall be named as the respondent in all proceedings brought by the filing of a petition...." 42 U.S.C. 300aa-12(b)(1).

[164] 42 U.S.C. 300aa-12(d)(1) (1987). As currently amended, this section, renumbered 300aa-12(e)(1), simply permits both "parties" to move for Claims Court limited review of a special master's decision.

[165] The program has had two Directors so far. The second accepted a new position elsewhere and is scheduled to leave in September 1990.

The Program Office appears to view its role in the Program as having two primary components. The first is protecting the fiscal integrity of the Trust Fund as fiduciary to preserve enough funds to permit the payment of compensation to all those who receive awards. The second is to ensure that only those petitioners whose injuries are clearly demonstrated to be listed in the Vaccine Injury Table or actually are caused by a covered vaccine are awarded compensation. This latter purpose reinforces the adversarial nature of Program proceedings. It is based on the Act's requirement that the special master or Claims Court shall award compensation to an eligible petitioner if "there is not a preponderance of the evidence that the illness, disability, injury, condition, or death...is due to factors unrelated to the administration of the vaccine...."[167] Although the Act does not charge the Program Office with responsibility for finding an unrelated cause of the injury or death, it is in the best position to identify such a cause and bring it to the Court's attention by virtue of its review of petitions and supporting evidence. Moreover, the Program office is the only party likely to bring an unrelated cause to the Court's attention. The vigilance with which it performs this function has been the subject of some controversy.[168]

The Program Office has experienced the greatest conflict between the role that its physicians prefer and that Congress may have envisioned, on the one hand, and the role it is given in the Act, on the other. While it may be desirable to have petitions assessed by independent medical experts, the Act made the Program Office, through the Secretary, the respondent in a two-party court action on a claim against the United States for money. Even if Program Office physicians would understandably prefer to act as independent advisers to the court, they have been statutorily categorized as the defendant in an adversary proceeding. But their status need not preclude them from offering an impartial opinion in any case. They are not under any obligation to oppose every petition simply to provide the government with a defense. Indeed, the Program was expected to avoid unnecessary adversarial positions. Still, reconciling the Program Office status as an adversary with its function as an impartial reviewer of medical issues defined by the Act is an especially difficult task.

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[166] Since neurological conditions in children form the bulk of adverse reactions listed in the Vaccine Injury Table and claimed by petitioners, the specialty of pediatric neurology is especially relevant.

[167] 42 U.S.C. 300aa-13(a)(1)(B).

[168] *See* text accompanying notes 84 and 85.

## The Department of Justice

The Department of Justice (DOJ) has acted as counsel for the Secretary of Health and Human Services and the Program Office before the Claims Court judges and special masters. The precise role of DOJ attorneys was somewhat unclear when the Program began. The DOJ was only peripherally involved in deliberations leading to the creation of the Program. While it had participated in an interagency task force that recommended some reforms in tort law in general, it had not been an active participant in the development of a vaccine injury compensation program. Thus, the department did not focus on preparing for an active role implementing the new Program.

Nonetheless, DOJ attorneys were assumed by many to be participants in the Program. The Attorney General is designated by statute to represent the Secretary in the federal courts.[169] Thus, there was no need to specify that the DOJ act as attorney for the Program Office. However, since the Program Office did not really expect to act as the petitioner's adversary, DOJ attorneys had a new but largely undefined role as its counsel.

The DOJ is fully familiar with representing federal agencies in federal courts. It is less active in representing the federal government in administrative proceedings. DOJ attorneys are primarily litigators. It should not be surprising, then, that DOJ attorneys acted like litigators when they first appeared in Claims Court proceedings. Physician reviewers appeared to appreciate having legal counsel to act on their behalf before the Court. They were unfamiliar with litigation and uncomfortable serving as expert witnesses. Moreover, there were at most two physician reviewers during the first year of the Program. If they had responded to each petition by means of a personal appearance before a special master, they feared they could not keep up with the timely basic review of petitions. The DOJ could present the reviewer's findings to the special masters and relieve the Program Office of this pressure.[170]

This working relationship was, at bottom, a traditional attorney-client relationship. Critics of DOJ representation have argued that DOJ attorneys were acting too much like traditional litigators, trying to defend the government against any claim against it, and opposing a petitioner's position as a matter of duty. While a few petitioners' attorneys expected this to be the role of DOJ, others found it too adversarial for their vision of the Program's purpose.

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[169] 28 U.S.C. 518 (1982); Hanagan v. Secretary, 19 Cl. Ct. 7, 10 (1989)(appealed on other grounds).

[170] This procedure was adopted by the DOJ and the Program Office in most early cases. Program Office physicians did not appear as witnesses in hearings before the special masters. Instead, DOJ attorneys submitted their reports as evidence.

One alternative source of Program representation would be the Office of the General Counsel of the Department of Health and Human Services, or its division, the General Counsel's Office within the Public Health Service (PHS). The PHS General Counsel's Office is more familiar with PHS programs, and with immunization issues and the Program in particular. It also frequently represents the PHS in administrative hearings and other proceedings, although less frequently in litigation. It may have had a comparative advantage over the DOJ in representing the Program Office in the Claims Court. However, the PHS General Counsel's Office considered that it had too few attorneys to take on the additional task of representing the federal government in all cases in the Program. Unfortunately, the DOJ found itself similarly stressed.

When the Program began, the DOJ assigned two full-time attorneys and one half-time supervisor to work on Program cases in the Claims Court. It apparently did not reorganize its staff so as to allocate specific resources for Program cases. Thus, DOJ attorneys found themselves with a new Program to learn, a commitment to represent the Program Office, and no new funds to create a division or office with sufficient resources to get the job done. In this respect, the DOJ felt as overextended as the Program Office physician reviewers. Several petitioners' attorneys complained that they had difficulty meeting Court directed deadlines, for filing stipulations of agreed facts, for example, because they were unable to reach DOJ attorneys by telephone. They believed that the DOJ attorneys were too busy to be able to return calls in a timely manner.

## A Request for Suspension and Problems with Participation

Within 2 months after case review began under the Program, the DOJ and the Program Office felt they could not continue the pace and comply with the procedures that were developing for deciding petitions. Ultimately, in April 1989, the DOJ, on behalf of the Program Office and incidentally for its own respite, brought a motion before the Claims Court to suspend proceedings for 90 days in all cases filed in the Program. The Chief Judge of the Claims Court invited petitioners' counsel to respond and held a hearing on the motion on

May 5, 1989.[171] The Court denied the motion, evidencing little sympathy for the position of the federal government.[172]

Both the DOJ and the Program Office argued that they could not handle the caseload and meet the statutory 365-day time period with the small numbers of attorneys and physicians that were assigned to the Program. They also were concerned that trial-like procedures employed by the special masters exacerbated the workload.[173] They wanted the 90-day moratorium to allow time to reconsider the decisionmaking process before it became fixed.[174]

Petitioners agreed that the time for processing cases was very tight, but felt it necessary to meet the Act's 365-day period for making decisions. They also agreed that many discovery orders were unnecessary, but argued that it was the Program Office, not the special masters, that requested the discovery they thought unnecessary. The disagreement crystallized a growing difference of opinion on the role of the Program Office and the interpretation of eligibility for compensation under the Act.[175]

The Claims Court did not take a position on this hidden controversy. Instead, it focused on the ability of the Program Office and the DOJ to perform their functions under the Act. While acknowledging the pressures of the Program's timeframe, the Court could not excuse government agencies from their responsibilities even when they were not provided with sufficient resources to perform them.

> [T]he court is convinced that it is respondent's (both the Department of Justice and the Department of Health and Human Services) lack of resources that has precipitated respondent's extraordinary request to suspend all vaccine cases. However, government's lack of resources cannot be allowed to penalize petitioners. When the United States undertakes a statutory program, this court must presume that

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[171] Gregson v. Secretary, 17 Cl. Ct. 19, 10 (1989). The Chief Judge chose to hear the motion because it presented an issue of immediate and general applicability to the Program as a whole and because he had not heard any individual petitioners' cases that might influence his judgment on the motion. He has maintained this division of labor, leaving the review of individual cases to other Claims Court judges.

[172] *Id.*

[173] In particular, they objected to frequent status conferences, with orders to complete discovery within especially short time periods, unnecessary and overly formal requirements for discovery, memoranda of law, lists of witnesses and exhibits, stipulations of agreed and disputed issues, and application of the rules of evidence at hearings. *Id.* at 21.

[174] Unfortunately, there was hardly any time for a leisurely analysis of programmatic efficiency. The clock was running and the time for final decisions on petitions filed early in 1988 was approaching rapidly.

> it has the minimal resources required to carry out the statute.[176]

At the time of the hearing, one of the DOJ attorneys had left, at least partly out of frustration at the caseload, leaving only one attorney actively participating in proceedings before the Claims Court. The Program Office also had only one physician in its employ at that time. More than 122 petitions had been filed and were being handled by eight special masters. The Court made it clear that, while it appreciated the burden on the individuals in the DOJ and the Program Office, there was no basis in law for excusing the federal government from meeting its own statutory obligations. It found it would be acceptable to allow individual motions for suspending particular cases for good cause shown, but did not grant the general suspension request. The Program was to continue.

In its petition seeking the general suspension, the DOJ noted its intention to limit participation by DOJ attorneys in the Program to "such action as is contemplated by 42 U.S.C. 300aa-12(d)(1)."[177] The Court refused to speculate on the meaning of this statement.[178] But as the Court probably inferred, the DOJ apparently meant that its attorneys would no longer participate in proceedings before the special masters; rather, they would limit themselves to filing objections to a special master's recommended decision and perhaps to representing the Program Office in any proceedings before a judge of the Claims Court. Whatever the specific intention, this is what the DOJ did. After the decision was issued on May 16, 1989, the DOJ ceased participating in proceedings before the special masters. It did not send attorneys to represent the Program Office in status conferences or hearings before special masters. Although it did follow through with some nearly completed cases it was handling, it generally limited itself to filing objections to a special master's decision and arguing against specific awards reviewed by the Claims Court. The Program Office continued to review petitions in order to identify

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[175] *See* text accompanying notes 84 and 85.

[176] 17 Cl. Ct. at 23.

[177] Quoted in *id*. at 20. The section referred to at that time provided: "Upon objection by the petitioner or respondent to the proposed findings of fact or conclusions of law prepared by the special master or upon the court's own motion, the court shall undertake a review of the record of the proceedings and may thereafter make a de novo determination of any matter and issue its judgment accordingly...."

[178] The Court required the DOJ to respond to specific questions about its intentions, including whether it would appear before special masters, whether it would file a notice of withdrawal as counsel of record in any pending case or in general as counsel for the Program Office, and whether a new attorney would be designated for either the Program Office or individual cases. *Id*. at 29.

petitions that were not eligible for compensation and frame objections to recommended awards, but did not participate in proceedings before the special masters. These circumstances persisted until mid-January 1990.

The lack of participation by the Program Office and the DOJ threatened the continuation of the Program. While it did not stop the processing of cases by special masters, it did make visible the underlying tensions among Program participants. The number of petitions filed dropped off somewhat during the months of June through September 1989, although summer vacations may have contributed to the decline. About 75 percent as many petitions were filed in the 9 months after the Court's decision on the request for suspension as were filed in the preceding 9 months. Thus, while the special masters were not inundated with new petitions, they still had to process a substantial number of cases without the assistance of the Program Office or the DOJ. Some petitioners found this advantageous because there was no opposition to their petitions. However, others were disconcerted when the DOJ interposed objections to a special master's recommendation for compensation after not having participated in the deliberations leading to that decision.[179] This often resulted in relitigating the case in its entirety before a Claims Court judge, duplicating much of petitioners' effort.

## The Technical Amendments

The Program could not operate efficiently in this manner or comfortably without the participation of the DOJ and the Program Office. All concerned began to seek a way to enlist their support. The first step was to find financial support to hire adequate staff to participate in Program proceedings. The next was to try to simplify the procedures employed by the Claims Court even more. The result was a group of Technical Amendments to the Act that were presented to Congress and adopted December 19, 1989 as part of the Omnibus Budget Reconciliation Act of 1989.[180] The statute did not become effective for

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[179] Some petitioners' attorneys moved to exclude a Program Office report or to strike an objection to a special master's recommendation that compensation be awarded on the grounds that it was unfair for the Program Office to refuse to participate and then attempt to reverse decisions it disagreed with on the basis of evidence that the petitioner had not seen and could not cross-examine for accuracy.

[180] The DOJ objected to certain portions of the Technical Amendments when it became aware of their existence, but ultimately acquiesced in their spirit after passage.

30 days--January 19, 1990--to provide a grace period in which to restructure Program procedures as required by the amendments.[181]

Congress clearly sought to straighten out what it perceived to be unnecessary problems with the implementation of the Program. The Committee Report on the Technical Amendments had a bad word for almost everyone:

> The Claims Court has issued rules...that force proceedings to be formal and that virtually foreclose any opportunity for petitioners or respondents to proceed without litigators at their side. Petitioners have failed to include adequate information in initial petitions and have pursued traditional rights of exclusion of evidence. Respondents have withheld sufficient personnel and administrative support and mounted defenses incompatible with a no-fault system of compensation.[182]

Members of Congress were particularly sensitive to the charge that the proceedings were adversarial. They recognized that statutory amendments could not overcome the more fundamental problems, which they characterized as "the nature of the adjudication of petitions." Instead, the Report said, "Correction of these problems will require revision of the vaccine compensation process of the Special Masters and U.S. Claims Court and a rededication of all parties to the creation of an expeditious, less adversarial, and fair system."[183] The Technical Amendments were intended to initiate a new era.

From the point of view of the Program Office and the DOJ, the merit of the Technical Amendments lay in their authorization of funds to hire new staff.[184] The Program Office, the DOJ, and the Claims Court each were allocated $1.5 million for the coming fiscal year. The DOJ set about hiring eight new attorneys, who would join the department by the spring of 1990. In the interim, the DOJ concentrated its limited resources on those few cases in which it felt a generally applicable question of law or principle was in dispute, and did not appear in the rest.

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[181] Thirty days proved to be insufficient to hire new personnel under federal government hiring procedures and allow the Program to make a real new start.

[182] Conference Report No. 101-386 to accompany H.R. 3299, Omnibus Reconciliation Act of 1989, 101st Cong. 1st Sess. 509, 512.

[183] *Id.*

[184] The Technical Amendments also made other changes in processing petitions. *See* text accompanying notes 153-155.

The Program Office was able to hire a new physician as a medical reviewer and look for others. In addition, the Program Office compiled a list of nonemployee physicians who were willing to serve as medical reviewers on an ad hoc basis. This was intended to relieve the staff physicians of the burden of reviewing all petitions. However, the time-saving has not been fully realized. The staff physician has continued to review all incoming petitions to select those appropriate for outside review. This can create a bottleneck that delays decisions. Moreover, the Program Office has had difficulty recruiting and retaining physician employees, and by June 1990 was back to only one full-time physician in its office.

While the Technical Amendments called for "a less-adversarial, expeditious, and informal proceeding,"[185] they did not change the basic structure of the Program. Nor did they alter the adversary relationship between petitioners and the federal agencies. The Program Office is still a respondent. The DOJ continues to act as counsel for the respondent, consistent with Congress' intent that it participate actively in the Program. Perhaps the most important contributions of the Technical Amendments were Congress' renewed commitment to the Program, backed by funds to staff it, and the catalyst they provided to all participants to work together to resolve difficulties in getting a new program off the ground.

# Chapter VI. Early Program Experience

This chapter summarizes data on petitions filed and decided under the Program through February 28, 1990. Although the statutory effective date for the Program was October 1, 1988, the Program did not begin to operate fully until February 1, 1989. It was not until November 15, 1988, that a Chief Special Master was in place to administer the process. Four special masters arrived at the Claims Court in January 1989, and began reviewing petitions by the beginning of February 1989. The remaining three special masters joined them in March 1989.

## Petitions Filed

As of February 28, 1990, 236 petitions had been filed with the United States Claims Court. (Table VI-1.) Twenty-four or 10 percent of these petitions were filed before the effective date of the Program, October 1, 1988. Since then, an average of 12 petitions were filed each month until the end of

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[185] 42 U.S.C. 300aa-12(c)(2).

February 1990. However, the rate of filing did not follow any pattern, with as many as 26 petitions filed in the month of November 1988, and as few as 3 petitions filed in August and September 1989.

### TABLE VI-1
*PETITIONS FILED*

| | Monthly | | | Cumulative | | |
|---|---|---|---|---|---|---|
| **Month Ending** | **Total** | **Death** | **Injury** | **Total** | **Death** | **Injury** |
| 3/1/88--<br>9/30/88 | 24 | 10 | 14 | 24 | 10 | 14 |
| 10/31/88 | 18 | 6 | 12 | 42 | 16 | 26 |
| 11/30/88 | 26 | 14 | 12 | 68 | 30 | 38 |
| 12/31/88 | 11 | 6 | 5 | 79 | 36 | 43 |
| 1/31/89 | 10 | 5 | 5 | 89 | 41 | 48 |
| 2/28/89 | 6 | 2 | 4 | 95 | 43 | 52 |
| 3/31/89 | 16 | 5 | 11 | 111 | 48 | 63 |
| 4/30/89 | 11 | 6 | 5 | 122 | 54 | 68 |
| 5/31/89 | 22 | 7 | 15 | 144 | 61 | 83 |
| 6/30/89 | 8 | 4 | 4 | 152 | 65 | 87 |
| 7/31/89 | 14 | 3 | 11 | 166 | 68 | 98 |
| 8/31/89 | 3 | 2 | 1 | 169 | 70 | 99 |
| 9/30/89 | 3 | 0 | 3 | 172 | 70 | 102 |
| 10/31/89 | 14 | 3 | 11 | 186 | 73 | 113 |
| 11/30/89 | 12 | 4 | 8 | 198 | 77 | 121 |
| 12/31/89 | 6 | 0 | 6 | 204 | 77 | 127 |
| 1/31/90 | 23 | 4 | 19 | 227 | 81 | 146 |
| 2/28/90 | 9 | 2 | 7 | 236 | 83 | 153 |

A surge of petitions were filed just after several important events took place. The first was, not surprisingly, during October and November 1988 after the Act became effective and the Claims Court formally began accepting petitions. The second occurred in May 1989, with 22 petitions filed, when the Claims Court refused to grant a request by the HHS Program Office to place a moratorium on the Program's operation. The third was in January 1990, with 23 petitions filed in the month in which the Technical Amendments to the Act took effect. It is possible that these events triggered filings, but given the fairly random distribution, it would be unwise to draw conclusions from the date of filing alone.

The total number of petitions filed has fallen short of some early estimates. Only 125 petitions were filed during calendar year 1989. When the Act was under consideration in Congress, the Congressional Budget Office first estimated that approximately 1,500 people might have suffered qualifying injuries in the preceding 8 years.[186] It assumed that all those eligible would file with the Program, and doubled its estimate as a precaution. Congress limited the total number of retrospective cases for which compensation could be awarded to 3,500 in the Act itself.

There are several possible explanations for the relatively small number of petitions filed thus far. One is that there might have been fewer serious adverse reactions to covered vaccines than predicted. In the absence of a formal reporting mechanism, such estimates had to be extrapolated from voluntary reports. However, voluntary reporting can miss a significant number of cases. Perhaps this led Congress to increase the number of cases predicted from the estimate of adverse reactions. Another reason for the shortfall in petitions filed may be that people who have suffered an adverse reaction to a vaccine may not be aware that it is vaccine-related. Lack of awareness seems less widespread than it might have been a decade ago because of media publicity surrounding childhood vaccines. In addition, an organization of parents of children with vaccine injuries or deaths has disseminated considerable information about adverse reactions to the DTP vaccine in particular.

A more plausible explanation may be that a significant proportion of persons with vaccine reactions are not aware of the availability of compensation under the Program. Media coverage of the Program has been sparse and, with some exceptions, generally limited to descriptions of the passage of the Act and its subsequent amendments. The Act charges the Secretary to develop information materials, but the Program Office has not been able to put a large publicity campaign in place yet. It now has an toll-free telephone number for inquiries about the Program and sends a packet of materials describing the Program upon request. However, people must be alerted to the Program's existence in order to call.

The Program office has published notices of its receipt of petitions in the Federal Register, but that publication is rarely seen by the public at large. It has also published announcements in several journals. Legal journals occasionally have reported on the Program's availability. The Special Masters Office presented an educational conference directed primarily at attorneys in April 1990. Medical journals directed at pediatricians have published a few articles on the Program by independent authors, but it is unknown whether pediatricians are informing their patients, since no one reported them as a source of information. The Program Office has reported receiving an increase in inquiries about the Program following one or two television programs that mentioned it or reported on an individual case.

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[186] Congressional Budget Office Estimate, Sept. 25, 1986, House Report No. 99-908, accompanying H.R. 5546, U.S. Code Cong. & Admin. News 6378, 6380 (1986).

Several petitioners' attorneys suggest that petitioners learned about the Program from newspaper or television reports or from a parents' organization. Many were already aware of the Program by virtue of having followed or worked for its enactment. A significant minority of petitioners had pending a civil action for the injury and their litigation counsel advised them of the Program. Interestingly, a few attorneys were unaware of the Program until a colleague or prospective client seeking representation mentioned it. So far, no one reported first learning about the Program from information or publicity disseminated by the Program Office. If this finding were to be confirmed in a larger survey, it should cause concern that information is not reaching the population likely to be eligible for its benefits.

It is possible that some potential petitioners may be aware of the Program but have concluded that they do not qualify for compensation. Their decisions not to file a petition may be based on advice from an attorney, a physician, or a parents' organization. Others with retrospective cases may have decided to take their chances in tort litigation, although preliminary interviews with attorneys for petitioners suggest this is unlikely.

One final possible explanation may be that prospective petitioners are waiting to file until the Program is running at full speed in order to move rapidly through the process. However, retrospective cases must be filed on or before October 1, 1990, so the time for waiting and watching is running out. Several petitioners' attorneys reported having additional cases they were preparing for filing before the deadline. The Program Office also reported that it was receiving an average of about five petitions, still largely retrospective cases, a week in June 1990. This is a significant increase, but the numbers fall far short of the 3,500 maximum.

Almost all of the petitions filed by the end of February concerned vaccines administered before October 1, 1988. As of March 1990, only nine prospective cases had been filed, and only one of these had been decided.

It would be unwise to predict the rate of petitions that might be filed for prospective cases from the experience with retrospective cases. After all, all prospective instances of serious adverse reactions must file with the Program first, while retrospective cases may have pursued litigation as an alternative to entering the Program. Prospective cases are likely to be filed at a more consistent annual rate since they must be filed within 2 to 4 years after the injury or death occurs. All the cases relating to pre-October 1, 1988 vaccinations are bunched into two filing years. On the other hand, before the Act was passed, the Centers for Disease Control estimated that perhaps 120 to

150 prospective cases would be filed annually under the Program. The higher estimate is in line with rate of all petitions being filed during the first half of the second year of the Program.

The majority of petitions filed as of February 28, 1990, request compensation for injury. Out of 236 petitions filed, 153 (64.8 percent) cited permanent injury, while 83 (35.2 percent) cited death. Cases of injury have been rising as a proportion of petitions filed since September 1989.

By far the largest proportion of petitions filed (82.6 percent) cite DTP or pertussis as the presumed cause.(See Table VI-2.) The next largest categories cite the MMR combination vaccine (5.9 percent) and polio (5.5 percent) as the presumed cause of death or injury. The remaining covered vaccines together are mentioned in only 6 percent of petitions filed as of February 28, 1990.

## TABLE VI-2

*Petitions filed as of February 28, 1990 by Vaccine Type*

| Vaccine | # of Petitions | percent of Total |
|---|---|---|
| DTP (diphtheria, tetanus, pertussis) | 176 | |
| DTP/Polio | 18 | |
| Pertussis | 1 | |
| Subtotal: All with Pertussis | 195 | 82.6 |
| DT | 3 | 1.3 |
| Polio | 2 | |
| OPV (oral polio vaccine) | 9 | |
| IPV (inactivated polio vaccine) | 2 | |
| Subtotal: All with Polio | 13 | 5.5 |
| MMR (measles, mumps, rubella) | 14 | 5.9 |
| Measles | 3 | 1.3 |
| Rubella | 5 | 2.1 |
| Measles/rubella | 1 | 0.4 |
| Mumps | 0 | 0.0 |
| Gammaglobulin | 1 | 0.4 |
| Smallpox | 1 | 0.4 |
| Total: | 236 | 99.9 |

## Reports by the Special Masters

The special masters began issuing their initial reports on petitions under the original rules within about a month after the full complement of eight Special Masters were in place in March 1989. (See Table VI-3.) Only one report was issued in April 1989, however, and none were issued in May 1989. This may have been attributable to the motion by the Program Office made in April 1989 to place a moratorium on the Program.[187] The Program got back on track in July 1989, and between August 1, 1989, and November 30, 1989, 53 reports were issued.

The special masters issued initial reports in a total of 76 cases as of February 28, 1990.[188] This represents 32.2 percent of the 236 petitions filed by that date. Sixty-five (85.5 percent) of these initial reports were decided by the end of November 1989, about 1 year after petitions formally began to be accepted. Fewer reports were issued each month after November 1989. One might hypothesize that the easier cases were decided more quickly, with those involving more difficult issues of causation or damages requiring more time. Almost all of the special masters and petitioners attorneys interviewed believed that the death cases were more speedily decided. The majority (43 out of 76 or 56.6 percent) of cases decided through February 1990 were cases involving death. But that leaves a substantial proportion (33 cases, or 43.4 percent) involving injury. Of the 11 cases reported between December 1, 1989 and February 28, 1990, 6 involved death and 5, injury. The time required for issuing a report appears to depend upon whether eligibility for or the amount of compensation is contested by the Program Office. Eligibility for compensation has been in dispute in a significant proportion of death cases where the Program Office believed that death resulted from a factor unrelated to the vaccine. Although similar issues were raised in many injury cases, such cases also require detailed, often contested, determinations of the amounts of compensation to be awarded.

Of the 76 cases in which special masters issued a report, Claims Court judges made final decisions in 70 cases, all under the original rules, and remanded 3 additional cases for further consideration by the special masters. Initial reports of the special masters were awaiting judicial review in 3 cases.

Judges adopted the recommendation of the special master for or against compensation in all but two cases. In one case, a recommendation against eligibility for compensation was reversed, and in another a recommendation for compensation was reversed. Judges also accepted the special masters' recommendation as to the amount of compensation in 60 of the 70 (85.7

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[187] *See* text accompanying note 171.

[188] Reports were not issued in 17 cases in the petitioner voluntarily dismissed the petition.

percent) cases decided by final judgment. In one injury case, a judge awarded more compensation than initially recommended by the special master. Judges awarded a lesser amount in nine cases of injury. The close congruence of the opinions of the special masters and judges suggests that granting special masters final decisionmaking authority, as the Technical Amendments did, is reasonable.

## TABLE VI-3

### *Special Master Reports Issued**

| | Monthly Total | Cumulative Total |
|---|---|---|
| April 30, 1989 | 1 | 1 |
| May 31, 1989 | 0 | 1 |
| June 30, 1989 | 4 | 5 |
| July 31, 1989 | 7 | 12 |
| August 31, 1989 | 12 | 24 |
| September 30, 1989 | 12 | 36 |
| October 31, 1989 | 15 | 51 |
| November 30, 1989 | 14 | 65 |
| December 31, 1989 | 8 | 73 |
| January 31, 1990 | 2 | 75 |
| February 28, 1990 | 1 | 76 |
| March 22, 1990 | 2 | 78 |

* Excludes voluntary dismissals by petitioner

## Disposition of Petitions

The disposition of cases for which a final judgment had been entered as of February 28, 1990, is shown by vaccine and type of injury in Table VI-4. A total of 87 cases had been finally disposed of, with final judgments entered in 70 cases. All but one were retrospective cases and all were decided under the original rules. Final judgments include all final decisions entered by order of a Claims Court judge after review of a special master's report and recommendations. Compensation (exclusive of attorneys fees) was awarded in 71.3 percent (62 out of 87) of final dispositions. Seventeen petitions were voluntarily dismissed by the petitioner, ordinarily because the injury did not qualify as compensable under the Vaccine Injury Table. One of these involved a smallpox vaccine which is not among the vaccines covered by the Program. Petitions voluntarily dismissed by the petitioner are not defined as final judgments because no action was taken on them by a special master or a judge. Two additional cases were involuntarily dismissed by order of a Claims Court judge upon the recommendation of special masters' reports. Moreover, six cases were awarded no compensation, although five of these were granted attorneys fees, which are permitted under the Act where the petition was filed in good faith but the injury is determined not to qualify for compensation. In the aggregate, 25 of the 87 decisions (28.7 percent) were dismissed or awarded no compensation.

Judges made final decisions by court order in 70 cases and awarded compensation in 62 (88.5 percent) of these. They denied compensation or dismissed the petition in 8 (11.4 percent) of these judgments. Of the 87 final dispositions, 71 (81.6 percent) were in cases citing DTP or pertussis as a cause of death or injury. It should not be surprising, then, that DTP cases accounted for the largest number of awards--51 cases, or 82.2 percent of the 62 petitions that received an award. Of these awards in DTP cases, 36 involved death while 15 involved injury. Twenty of these DTP cases received no award or were voluntarily dismissed; this represents 80 percent of all cases that were dismissed or denied compensation.

No other vaccine accounts for more than a handful of decided cases. Only three cases involved polio vaccine. Awards were made in two of those cases; one was voluntarily dismissed. Decisions were made in eight cases involving the combined measles-mumps-rubella vaccine (MMR), with awards granted in all but one. Two cases involved rubella and two cases the diphtheria-tetanus combination vaccine. In both types of cases, an award was made in one case while the other was voluntarily dismissed. No cases decided before March 1, 1990 considered IPV, or diphtheria, measles, or mumps vaccine alone.

## Table VI-4
*Final Decision AS OF February 28, 1990*

| Vaccine | Voluntary Dismissal | | Involuntary Dismissal | | Award of No Compensation | | Award of Compensation | |
|---|---|---|---|---|---|---|---|---|
| | Death | Injury | Death | Injury | Death | Injury | Death | Injury |
| DTP or P | 4 | 8 | 1 | 1 | 1 | 4 | 34 | 15 |
| DTP/Polio | | | 1 | | | | | 2 |
| DT | | | 1 | | | | | 1 |
| Diphtheria | | | | | | | | |
| Polio (OPV) | 1 | | | | | | 1 | 1 |
| Polio (IPV) | | | | | | | | |
| Measles | | | | | | | | |
| MMR | | | | | | 1 | 3 | 4 |
| Rubella | | | 1 | | | | | 1 |
| Mumps | | | | | | | | |
| Smallpox | | | 1 | | | | | |
| Subtotals | 5 | 12 | 1 | 1 | 1 | 5 | 41 | 21 |
| TOTAL | | 17 | 2 6 | 62 | | | | |

## Compensation Awarded

The Program awarded $32,495,151.17 in compensation (exclusive of attorneys fees) in final judgments as of February 28, 1990. Of this amount, a total of $10,250,000 was awarded in cases of death, with the award being $250,000 in each of 41 cases. The balance of $22,245,151.17 was awarded in 22 cases of injury. Table VI-5 shows the total and average amounts awarded by vaccine.

In cases of injury, the amount of compensation ranged from a low of $27,081 to a high of $2,772,855. The average award was $1,011,143.21. Nine of the 22 awards were more than $1 million. All of the compensation in injury cases was awarded for future medical, rehabilitative and custodial care expenses (to be incurred after the date of judgment), since all of these cases were retrospective cases which the Act precludes from receiving past medical expenses. The Act also caps lost earnings and pain and suffering together with attorneys fees at $30,000. Only one prospective case had been decided by the end of February 1990. It involved death and resulted in compensation in the amount of $250,000.

The compensation awarded during the first 17 months of the Program has been well within the $80,000,000 per year appropriated by Congress. At the same time, the number of cases decided has been significantly less than Congress expected. It can be seen that if each successful injury case were awarded $1 million, fewer than 80 retrospective injury cases per year could be paid, since some awards would be paid in retrospective death cases. There does not appear to be any immediate threat to the funds available for retrospective cases. The amounts of compensation in prospective cases may be expected to be higher since they may include past expenses and will brought on behalf of younger children. Thus, it will be important to monitor the amount of awards in prospective cases to ensure that the Trust Funds are adequate.

### TABLE VI-5

*Compensation ($) Awarded as of February 28, 1990*

| | TOTAL | | AVERAGE | |
|---|---|---|---|---|
| Vaccine | Death | Injury | Death | Injury |
| DTP + DTP/P | 9,000,000.00 | 18,058,486.48 | 250,000.00 | 1,128,655.03 |
| MMR | 750,000.00 | 2,637,540.19 | 250,000.00 | 659,385.05 |
| OPV | 250,000.00* | 499,575.50* | 250,000.00* | 499,575.50* |
| RUBELLA | | 1,049,555.00* | | 1,049,555.00* |
| DT | 250,000.00* | | 250,000.00* | |
| TOTAL | 10,250,000.00 | 22,245,151.17 | 250,000.00 | 1,011,143.21 |

* Only one award made in category

## Attorneys' Fee Awards

Of the 88 cases decided by the end of February 1990, the final judgment included an award of attorneys' fees in 65 cases (73.9 percent). Attorneys' fees were awarded in 60 (95.2 percent) of the 63 cases in which compensation was also awarded. One fee award remained pending. Attorneys' fees were also awarded in five (83.3 percent) of the six cases which received no compensation award. No fee award was made in the case of voluntary dismissal by the petitioner.

Amounts awarded for attorneys' fees are shown in Table VI-6. Unexpectedly, in DTP cases, the average award is slightly higher where the adverse reaction resulted in death than where permanent injury without death resulted. One possible explanation could be that it has required more time and expense for attorneys to demonstrate that a death resulted from DTP than an injury. This might arise in cases in which the Program Office opposes a petition on the theory that the death did qualify as a Table injury, thereby forcing the petitioner to prove that the death resulted from the vaccine.[189]

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[189] *See* text preceding note 94.

## TABLE VI-6

*Attorneys Fee Awards in Final Judgments as of 2/28/90*

| | DTP | MMR | RUBELLA | OPV | DT |
|---|---|---|---|---|---|
| Aggregate: | | | | | |
| Death | 757,345.62 | 59,881.00 | | 7,040.00* | 16,607.74* |
| Injury | 303,316.73 | 72,342.37 | 25,099.00* | 25,886.76* | |
| All | $1,060,662.35 | 132,223.37 | 25,099.00* | 32,926.76 | 16,607.74* |
| Average: | | | | | |
| Death | 21,037.38 | 19,960.33 | | 7,040* | 6,607.74* |
| Injury | 18,957.30 | 18,085.59 | 25,099.00* | 25,886.76* | |
| All | 20,397.35 | 18,889.05 | 25,099.00* | 16,463.76* | 16,607.74 |

* Only one award made in this category

## Attorneys' Representation of Petitioners

Virtually all of the petitioners who pursued a claim in the Program were represented by counsel. All but perhaps two or three have retained an attorney to file their petitions. Those that did not have counsel before filing were afforded the opportunity to retain an attorney by the special masters assigned to their cases.

The overwhelming use of attorneys may be explained in several ways. Few petitioners are confident of their ability to gather and present evidence sufficient to prove their cases without an attorney. Others may prefer to distance themselves from analyzing their children's deaths or injuries in detail, in order to avoid painful memories. It is possible that many petitioners seek the advice of an attorney about whether any remedy is available, perhaps even before they are aware of the Program's existence.[190] Some parents may first contact the parents' organization which may refer them to one or more attorneys.

As of February 28, 1990, the vast majority of attorneys who represented petitioners (103 out of 128 or 80.5 percent) had filed only one case. (See Table VI-7.) Twenty-five attorneys (19.5 percent) had filed two or more cases. Of these, 12 had filed only two cases; 4 had filed three cases; 1 had filed four cases; 2 had filed five cases; 1 had filed six cases; and 1 had filed nine. Only four attorneys had filed 12 or more cases. Of these four, one had filed 12, one 15; one 17; and one 23 cases. One case was filed *pro se* (by the petitioner). The 128 petitioners' attorneys were located in 41 states.

Fewer than half of the cases, 43.6 percent (103 of the 236 petitions filed), were represented by an attorney having only one case. About twenty-nine percent (28.8 percent) of the cases (68/236) were represented by one of four attorneys who had filed 12 or more cases. Twenty-five attorneys together had 128 cases (53.8 percent of all cases). These figures do not indicate any pattern of representation common to all petitioners. However, attorneys with diverse backgrounds and specialties have represented petitioners in concluded cases. Some specialize almost exclusively in vaccine litigation, some are litigators without previous experience in vaccine cases, and others are not litigators. If a wide variety of attorneys are willing to represent petitioners, the Program should be reasonably accessible. However, some attorneys who are not experienced in vaccine litigation say they are likely to refer future cases--at least those that present any problem of proof--to specialists in vaccine litigation. If vaccine specialists are more efficient at presenting cases, such a development might expedite decisionmaking. It might also concentrate Program cases in the hands of a small number of attorneys. If potential petitioners find it difficult to locate a vaccine specialist, however, they be dissuaded from entering the program.

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[190] The Act specifies that attorneys have an ethical obligation to advise clients who consult them with respect to a vaccine-related death or injury that compensation may be available under the Program. 42 U.S.C. 300aa-10(b).

### TABLE VI-7
### *Distribution of Petitioners Attorneys by Case Filed as of February 28, 1990*

| Numbers of Cases Filed (Total 236) | Number of Attorneys (Total 128) |
|---|---|
| 1 | 103 |
| 2 | 12 |
| 3 | 4 |
| 4 | 1 |
| 5 | 2 |
| 6 | 1 |
| 9 | 1 |
| 12 | 1 |
| 15 | 1 |
| 17 | 1 |
| 23 | 1 |

# Chapter VII: Summary and Conclusions

The National Vaccine Injury Compensation Program is a creative policy mechanism to compensate persons with vaccine-related injuries and reduce the need for litigation. It establishes a no-fault compensation system that is expressly intended to avoid disputes concerning legal responsibility for injury and make decisions expeditiously. The Program's design fosters these goals in several ways: by substituting a defined list of compensable injuries, the Vaccine Injury Table, for the need to prove the actual cause of injury; by limiting the time within which decisions must be made to a period far less than ordinary litigation; by empowering special masters to determine eligibility for and amounts of compensation; by specifying available compensation that reflects actual financial losses; and by emphasizing procedural flexibility to make the process simple and congenial. Almost everyone involved with the Program recognizes its special function and structure and is committed to making it run smoothly.

Whether the Program's promise will be fully realized remains to be seen. It suffered not only from ordinary difficulties of any new endeavor, but from some confusion both in identifying the Program's objectives and in devising ways to meet them, as well as from limited resources. In consequence, the Program is only now beginning in earnest.

The experience of the Program to date may not be representative of its future operation. Aside from having undergone significant changes, both statutorily and programmatically, the Program has dealt almost exclusively with retrospective cases. The future of the Program lies with prospective cases. The procedures developed to decide retrospective cases should apply reasonably well to prospective cases. But, the Program's acceptability, and consequently its effectiveness, may be affected by prospective cases. Therefore, whether the findings presented in this report will apply in prospective cases can only be assessed by testing them against future Program operations.

To begin to generate hypotheses about how the Program may work, this study surveyed Program participants. Participants in the Program--in the Office of the Special Masters, the Department of Justice, the Program Office at the Department of Health and Human Services, and a nonrandom sample of petitioners' attorneys--were asked what they liked and disliked about the Program.

## Positive Aspects of the Program

Positive features of the Program mentioned most often concerned the Program's design and potential speed and efficiency. Most participants like the fact that the Program establishes a list of compensable injuries and a simplified method for determining entitlement to compensation, although a few questioned the wisdom of including one or two specific injuries in the Table. The use of designated compensable injuries tends to remove many complex questions of causation as a subject of dispute, thereby shortening and simplifying the decisionmaking process. The relative speed, compared with litigation, was seen as especially valuable to all concerned. In general, the special masters were viewed as objective or very objective and as able to move petitions through the review process quickly and efficiently.

Thus, the Program is generally, but not unanimously, viewed as having significant potential for being more efficient than litigation. The Congressional appropriation, made in the 1989 Technical Amendments, to fund Program activities considerably strengthened the commitment to the Program of those charged with administering it. It seems to have generated a new sense that the Program's potential can be realized.

Other positive features from petitioners' point of view include the Program's recognition, by its very existence and by the issuance of judgments awarding compensation, that people have become disabled or have died following vaccination with required vaccines and that the country is willing to provide them with necessary financial assistance. A few also indicated that the amount of compensation awarded under the Program was closer to actual losses and somewhat more generous than that ordinarily obtained in settling litigated cases. Thus, the Program was seen by many as more attractive than litigation.

Additional positive features were mentioned by only one or a few persons but may be corroborated by future research. For example, vesting decisionmaking authority in an impartial person who is neither a physician nor affiliated with immunization programs makes sense to many. Many medical and public health professionals with expertise in immunization have expressed opinions on vaccine reactions and could be seen as insufficiently impartial for purposes of the Program. At the same time, because the special masters hear only Program cases, they can become familiar with the subject matter and begin to render decisions based on specialized knowledge. The fact that the special masters are granted inquisitorial powers to question witnesses and demand the production of necessary evidence was seen by some as a practical advantage for moving cases along. They also have the power to seek advice from independent experts, although few have exercised it, possibly because of the difficulty of locating experts viewed as genuinely impartial by all concerned. The Technical Amendments clarified who is responsible for producing particular documents and reports and for making decisions, so it is now easier to identify how to correct a problem if one occurs.

In addition, several participants mentioned the utility of having petitions reviewed by medical professionals. While the Program Office was criticized by some, most agreed that HHS was probably the best choice among federal agencies for conducting medical reviews.

## Difficulties in the Program

Problems with the Program most frequently mentioned were the earlier lack of participation by the Program Office and DOJ and disagreement in a large proportion of cases in the interpretation of the Vaccine Injury Table or the evidence necessary to prove a Table injury. The DOJ's lack of participation during the last half of 1989 frustrated the course of deciding cases. In the absence of legal representation, the Program Office was unable or unwilling to participate in hearings where evidence of causation could be presented and evaluated. While the Act does not require Program Office participation in determining eligibility, the special masters expected participation. Some special masters felt constrained to consider written Program Office reports as part of the record in order to produce a fair opinion. However, this use of written reports did not provide petitioners with an opportunity to question or challenge the medical reviewer's basis for an objection to eligibility. This was perceived as unfair by some attorneys.

The funding provided as a result of the Technical Amendments should alleviate the problem of lack of participation by allowing the DOJ and the Program office to hire staff. However, the full complement of the DOJ staff attorneys was not in place until April 1990, almost a year after the initial withdrawal of participation. The Program Office has only one full-time physician and is making do with part-time and contract physicians. Cases that had to be decided within the statutory period of (then) 1 year could not benefit from the new funding. It was expected that sufficient staff would have joined the Program Office and become familiar with its requirements by summer 1990 to permit the Program to operate smoothly. When combined with the changes in decisionmaking authority made by the Technical Amendments, however, the recent gearing up of DOJ and, to a lesser extent, the Program Office means, that the Program is only now in full operation--a place where new programs are ordinarily expected to be within 6 months of the effective date.

The second major problem with the Program was disagreement over the function of the Vaccine Injury Table, as described in Chapter III. The Program Office's initial difficulty in appreciating the distinction between legal causation embodied in the Table and causation-in-fact as more commonly used in medicine increased the proportion of disputed cases. Although it is now clear that the Table sets forth a list of compensable injuries, the Program may be affected by external differences of opinion as to the specific medical conditions that should be included in the Table. A more difficult problem acknowledged by most participants was disagreement on the proof that is or should be required to demonstrate a Table injury. The Act's aids to interpretation have not proved dispositive in many cases. The variation in symptoms experienced by individuals as well as how these are documented often made it difficult to determine whether a Table injury in fact occurred.

A related concern of many participants involved the use of expert witnesses. While experts may be impartial as to the merits of each individual case, many have formed opinions on the more general issue of causation. The repeated use of some experts willing to review cases or testify in Program proceedings may affect the perception of fairness. On the other hand, it is not clear whether participants would be comfortable with substituting independent experts called by special masters for experts of their own choosing.

Other problems mentioned include a perception that there is little public awareness of the Program which may have contributed to the lower than predicted number of petitions being filed. Some felt that this could be attributed to the meager publicity given the Program. If the number of petitions filed increases during the summer of 1990, it may be difficult to process them in a timely fashion with the Program Office's limited staff.

## Conclusions

Although many participants saw difficulties in the Program, most were enthusiastic about its continuation. The difficulties were seen as largely in the past, the future as full of promise. In essence, two programs were being evaluated--the original Program and the new rules included in the Technical Amendments. The Amendments gave the special masters the authority to operate a more informal, flexible process. They also gave the Program the resources needed for full participation. Thus, the Program is now operating with more support and is closer to the simplified streamlined system originally envisioned.

At the same time, the Technical Amendments did not alter the Act's basic programmatic structure for the Program. While it is less adversarial, it remains an adversary format, with a petitioner bearing the burden of proving a claim, a respondent able to object to the claim and its proof, and a special master charged with the duty to reach a decision supported by the evidence. Virtually all decisions under the Program, from interpreting the statute to weighing the evidence to calculating compensation, must be reached by an independent decisionmaker--a special master or Claims Court judge--after hearing from opposing sides. Since there is no administrative entity that can issue general regulations interpreting ambiguous statutory provisions or establishing methods to calculate compensation, such decisions must be made much as common law is made, by the accretion of decisions in individual cases. The one area in which the Secretary may regulate--revising the Vaccine Injury Table--may be too sensitive to permit unilateral action.

The adversary posture of the parties has not hampered the decisionmaking process as much as misapprehension of expected roles did. In the future, the Program may discover the irreducible minimum amount of time required to decide contested cases. Informal procedures are not likely to make it any easier to resolve questions of fact about the nature and cause of an individual's injury. The time needed to resolve such issues is not necessarily wasted, nor is it a sign of programmatic failure. Indeed, the fact of resolution could be considered programmatic success.

It cannot be forgotten that the Program was created not only to provide fair compensation for vaccine-related injuries, but also to quell a seemingly insoluble debate over adverse reactions to vaccines. The fundamental question is whether a decisionmaking process can settle such a controversy. The answer may be yes, if controversial policy issues are removed from the process itself.

## Applying Lessons from the Program

It is reasonably clear that Congress viewed the Program as *sui generis* and not as a precedent for compensating personal injuries from other causes. Representative Waxman made this point quite clearly in introducing the bill in 1986, and has reiterated that position publicly.[191] In discussing a predecessor bill, Senator Hawkins and Deputy Assistant Attorney General Willmore agreed that the compensation system presented a unique situation, primarily because the government requires childhood immunizations.[192]

Many of those who originally opposed the Program did so because they feared it would create a model for dealing with other personal injury problems. The administration was concerned about the potential cost of multiple or expanded compensation programs funded though government, and instead tended to favor limiting the compensation payable in tort actions as an alternative.

In spite of these intentions, the Program has been suggested as a model to solve other policy problems. Congress is considering a compensation system explicitly modeled on the Program to compensate uranium miners and other civilians exposed to above ground nuclear testing.[193] The Program has also been considered, but not explicitly adopted, by private committees as a model for compensating adverse reactions to investigational or approved HIV vaccines, to remove any disincentive that future litigation might pose to HIV vaccine development. In addition, it is conceivable that the Program itself could be expanded to cover additional vaccines, particularly those that are recommended for children. The Program has also been mentioned as a model in alternative proposals for no-fault compensation of injuries related to medical practice.

Such recommendations could pose difficulties for the Program. Adding new vaccines to the Vaccine Injury Table is contemplated by the Act, but could undermine its basic justification if the new vaccines are not required for children. A more practical problem would be developing an acceptable list of compensable injuries to include within the Vaccine Injury Table. Vaccines newly approved by the Food and Drug Administration will not have been in use long enough to identify serious adverse reactions. The Program could cover new vaccines without listing compensable injuries in the Table if petitioners were required to prove that the new vaccines actually caused their injuries. While the Program might be able to handle such a requirement, it could require longer decisionmaking periods and more expensive traditional methods of proof. It would also create a bifurcated system, with legal definitions of compensable injuries for vaccines now covered and requirements for proving actual causation in new vaccine cases. Most important, it could undermine the rationale for and utility of the Vaccine Injury Table for the vaccines currently covered.

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[191] Remarks of Rep. H. Waxman, Conference on the National Vaccine Injury Compensation Program, Washington, DC, April 27, 1990.

[192] Hearing on S.827, July 18, 1985.

[193] The bill passed the Senate in August 1990, and has been submitted to the President for signature.

It is likely that the Program will receive additional attention as a model for resolving policy problems that involve liability for injury, socially beneficial products or services, and injured persons in need of financial assistance. In the absence of any system of social insurance that covers injuries regardless of cause, narrower cause-based compensation systems offer a source of needed assistance. Whether or not multiple systems are an appropriate policy choice, it seems inevitable that they will be considered. In its current posture, the Program is not likely to be a generic model.

This is not to say, however, that elements of the Program are by their nature nontransferrable. Several structural and procedural components might fruitfully be incorporated in administrative benefit, administrative tribunal or litigation systems. For example, the front-end loading requirement can be used in most decisionmaking systems (where it is not already being practiced) to speed up the collection of all relevant information. Discrepancies and missing information can be identified and remedied early in the process. This gets decisionmaking under way promptly. Of course, there must be an adequate number of decisionmakers to be able to delve into the substance of a claim promptly upon its receipt, since there is little time spent waiting for additional papers to be submitted.

The Rule 5 Conference format can be applied in a variety of settings also. It can be used as a screening mechanism to identify claims that are patently eligible or ineligible for benefits, allowing limited time and resources to be concentrated on the more difficult cases. It also serves to facilitate resolution of claims. Off the record discussions encourage participants to settle disputes. There is little incentive to adopt a negotiating posture for purposes of building a record. Moreover, the special master's reaction to the case, in the form of a nonbinding preliminary opinion, gives the participants an objective assessment of their positions. They can identify any additional proof needed to make their positions persuasive or accept the opinion as properly dispositive of the case. This should encourage both the best presentation of each position and expeditious resolution of claims. Rule 5 Conferences seem especially suitable for administrative tribunals that handle cases involving the same or similar subject matter. For the same reason, they can be used in administrative benefit determination proceedings. They especially could be useful where claimants deserve an opportunity to explain written claims and supporting documentation, but there is little need for a formal hearing.

The use of telephone conferences is also adaptable to almost any decisionmaking system. They appear particularly advantageous in systems with limited resources, as most are currently. However, they are likely to be most effective where the decisionmaker knows the participants and can assess their credibility. Personal or professional credibility is not always an issue, of course. Telephone conferences are a useful way to conduct informal conferences and formal hearings of all types.

The establishment of a designated unit of special masters or other decisionmakers to decide specific kinds of cases could be adapted for several uses. Although similar in concept, this structure differs from earlier proposals for specialized courts (like a science court or medical malpractice tribunal) in that it could be used within a court of general jurisdiction. Moreover, it can operate more easily as an administrative review mechanism without being bound by the court's rules of practice. Special masters dedicated to one technical subject matter (or several, where the caseload for each is small) have an advantage in understanding and evaluating cases because of familiarity with the subject matter. Their expertise should permit special masters to issue high quality decisions in a minimum amount of time. The dedicated special master unit concept can be applied in courts and in some administrative benefit systems. Among the latter, special masters may be best suited for making decisions that require decisionmakers who are independent of the agency responsible for paying the benefits claimed.

## Recommendations for Evaluation

The findings reported herein are descriptive of the Program's operation during its infancy. The Program's importance and the likelihood that it may operate differently, perhaps more efficiently, in the future, warrant a more comprehensive evaluation of the Program's operation during the next few years. Congress recognized the need for such an evaluation in the Technical Amendments. Moreover, to make a responsible decision whether or not to continue the Program after 1993, Congress should be provided with a careful analysis of the program's operation and effectiveness. The following discussion outlines the major issues that should be addressed in evaluating the Program.

Evaluating the Program requires identifying Program objectives. The task is complicated somewhat in this case because of the breadth, ambiguity, and occasional conflict in the goals of those who supported legislation authorizing the Program. Many members of Congress hoped that the Program could solve the entire complex of problems affecting immunization rates, the supply of vaccines, the price of vaccines, future improvement of vaccine safety and effectiveness, and the compensation of injured persons. Thus, the Program was expected to contribute to stabilizing, and ideally increasing, domestic vaccine production by private companies.

There are several possible measures of Program effectiveness in meeting this objective--several because the objective is multifaceted. First, one might compare levels of vaccine production before and after the Program took effect. This preliminary evaluation does not attempt such a comparison because it will require several years of Program operation before any long-term effect on vaccine production could arise. Manufacturers may be expected to base future production plans on what they consider to be stable market conditions. The Program has not operated consistently for more than several months at a time as a result of the withdrawal of Program Office and DOJ participation and the Technical Amendments to the Act. Moreover, the Program has handled primarily retrospective cases that are funded out of Congressional appropriations rather than a surtax on vaccine sales. Therefore, the vaccine industry has not yet seen whether the Program will prove more or less costly to it than the risk of litigation. Also, the industry may prefer to wait to pass judgment on the Program until a year or two of prospective cases have been decided, when the incidence of petitioners who reject Program awards in favor of litigation can be empirically determined.

A preliminary estimate of the Program's effect on vaccine production could be attempted after the Program has completed at least 1 year of deciding prospective claims. At that time, it will be important to assess not only the number of doses of vaccine produced, but also the number of manufacturers producing vaccines covered by the Program. The number of vaccine doses must also be adjusted by the birth rate and expected market for immunization.

In addition, in order to evaluate the effect of the Program itself on vaccine production, the analysis must take into account other factors that may influence private sector decisions. For example, the expected future birth rate in the United States and the maximum tolerable price of vaccines will define the domestic market and whether continued production is sufficiently profitable when compared with other activities. New markets for vaccines may open up to encourage production, or old markets may shrink or become unprofitable. The condition of factories and laboratories and the cost of renovation or new construction may influence production plans. The technology used for vaccine production may prove a hindrance if it is suitable for only one product, or a cost-effective investment if it is useful for several lines of products. Thus, the evaluation should be able to collect sufficient data and employ an analytic method that will differentiate the real effect of the Program on industry decisions to produce childhood vaccines.

Determining the effect of the Program on immunization rates presents similar problems, albeit simpler ones. Obviously, any comparison of immunization rates before and after the Program took effect would require adjustment for the size of the population for whom immunization was recommended. Other factors influencing acceptance of childhood immunization would need to be weeded out. These might include the availability of private and medicaid insurance coverage for immunization, the availability of free immunizations at public clinics, a public educational campaign to encourage immunization, any change in the proportion of the population who declined immunization for religious reasons, and especially influential publicity about immunizations or adverse reactions to vaccines.

A second objective of the Program was to provide a mechanism for insuring fair and adequate compensation for injury resulting from vaccination. Parents of disabled children, as well as other supporters of the Act, viewed this as the real, and perhaps most attainable goal. Again, litigation was viewed as a problem, not because it cost too much, but because it resulted in too few instances of compensation.

Evaluating the Program's effectiveness in achieving this objective is also complicated. While adequacy of compensation could be measured by comparing awards against the losses incurred by petitioners, the fairness of compensation is not necessarily measurable by objective standards. Query whether it is "fair" to specify $250,000 as compensation for a person's death? Does it matter whether a state's wrongful death act prescribes a greater or lesser amount? What is fair compensation for noneconomic losses like pain and suffering? Should it be commensurate with civil litigation awards or established by a schedule of functional losses? Should awards for lost earnings be calculated on the basis of actual individual losses, or be standardized so that everyone is compensated at the same rate? Because the Act specifies the terms of compensations, it incorporates an implicit congressional judgment of what is fair. However, this judgment may be challenged in the future if other changes, such as a recommendation to reduce costs, are proposed.

Estimating the adequacy of compensation is conceptually much easier, but does entail making some assumptions that could prove inaccurate. A survey of petitioners to ascertain their actual expenditures in caring for an injury seems necessary, even though self-reports are often unreliable. A sample of petitioners might be studied in greater depth, either to estimate reliability or to construct an estimate of expenses incurred by all. Estimates of future expenses depend upon the validity of actuarial assumptions, estimates of future economic costs of care, and the inflation rate.

The objective of providing fair and adequate compensation also included the idea that a larger proportion of persons permanently injured as a result of vaccines would receive compensation. This calls for two types of measures.

The first is a measure of whether all those who are injured and desire compensation have access to the Program and file a petition. The higher the ratio of persons filing petitions to persons injured, the more effective the Program. The numerator of the ratio can be taken from Program records. The denominator can only be estimated from CDC reports and the medical literature for retrospective cases. Better estimates should become available as the reporting of adverse reactions required by the Act is implemented.

The second measure of the Program's effectiveness in providing compensation to injured persons is the proportion of the Program's final decisions that is "correct;" that is, decisions that award compensation to petitioners for injuries listed in the Vaccine Injury Table and for unlisted injuries that are demonstrated to be caused by the vaccine. Unless the final judgment is assumed to be correct, this requires an independent assessment of the merits of petitions.

It would also be useful to determine whether the Program provides more or less compensation on average than do awards resulting from judgments or settlements in tort litigation. If the Program offers more compensation than most tort cases, injured persons are more likely to prefer the Program to litigation, and vice versa, of course. However, data on settlements has not been provided voluntarily by industry in the past. For this preliminary evaluation, a sample of petitioners attorneys were asked how Program awards compared with litigation. A similar proxy measure could be used in the future.

A third objective of the Program is impliedly incorporated in the first two--that the Program will reduce tort law claims against vaccine producers by serving as a substitute for litigation. As noted earlier, it is too soon to predict whether the Program will achieve this objective, although there are anecdotal reports that civil law claims have already decreased. In a few years, it may be possible to compare the claims made against vaccine producers after prospective cases have been through the Program with tort claims made in the 1980s, for example. However, to do so, it will be necessary to obtain data on claims made from the vaccine industry or its insurers where relevant. If such information is deemed important, it may be necessary to amend the Act to require it to be furnished if it is not offered voluntarily.

Program costs also influence its comparative advantage over litigation. To estimate the comparative costs of each to industry, it should be possible to calculate the aggregate amount of vaccine surtax costs and estimate the costs of litigation to industry. However, the reluctance of industry to disclose litigation costs may also create an obstacle to collecting this data.

The Program can only serve as a substitute for litigation if injured persons are aware of its existence. Thus, one measure of the Program's capacity to serve in lieu of litigation is the degree to which information about the Program is available. This can be estimated by identifying informational materials prepared on behalf of the Program and by private organizations, the breadth of their dissemination (geographically and by target populations), and by surveying petitioners and nonpetitioners to determine whether and how they learned about the Program. Here, the major obstacle lies in identifying eligible persons who have not entered the Program.

Realistically, access to the Program is also rationed by access to attorneys willing and able to represent petitioners. So far, virtually all petitioners have sought representation by counsel in order to file and pursue a petition. Unless this changes dramatically, an unlikely event, the availability of attorneys will affect the number and type of petitions filed. The availability of attorneys can be measured in several ways. One is by a survey of attorneys. This has the disadvantage of possible inaccuracy as in any self-report. It may also fail to reach the entire pool of attorneys available unless a nationwide survey of all those admitted to the bar is conducted. Alternatively, attorney availability could be estimated by comparing the amount of attorneys' fees awarded to the costs of representing petitioners. This would entail estimating the costs of representation. In addition, one could infer the adequacy or inadequacy of the level of attorneys' fees from any increase or decrease in representation by attorneys who had filed petitions in an earlier year, although this would require adjustment for specialty and the instances in which an attorney handled only one case as a favor to a client or friend. Finally, since the choice of accepting the decision of the Program or pursuing a tort law claim lies with the petitioner, the petitioners' satisfaction with the compensation awarded will affect the Program's appeal. This can be measured in a survey of petitioners.

Much of the Program's success in achieving the above objectives lies in its effectiveness in operating an efficient administrative process. Here, more numerous and feasible measures of process, both objective and subjective, are available. These include the level of compliance with petition and documentation requirements, and the proportion of petitions to which an objection is filed by the Program Office. These may indicate that Program requirements remain unclear or that participants are misinterpreting the eligibility rules. Another measure of process efficiency is the time required to reach a final decision on petitions, and whether the time is within statutory limits. Lengthy proceedings may indicate either legitimately difficult cases or unnecessary obstructionism or simple inefficiency. Time estimates may also indicate whether statutory limits are realistic, although extending those limits may frustrate other objectives. Costs of administration also affect estimates of efficiency. Such costs, including staff time, can be compared with those of other compensation programs. Staff turnover rates and caseloads can also be studied.

More subjective measures include levels of satisfaction with the Program's process reported by all participant groups, including petitioners and their attorneys. This may include perceptions of efficiency and objectivity on the part of other participants.

Other measures of Program efficiency relate primarily to outcomes. For example, the proportion of awards that are appealed by either petitioner or respondent indicates the degree to which participants believe that the Program is making accurate or defensible decisions. The proportion of the trust fund paid out in awards will also indicate the economic efficiency of the Program and the levels of vaccine surtax.

These objectives of the Program are summarized, but not in any rank order, in Table VII-1. Examples of possible measures of effectiveness in achieving the objectives are also listed in the Table.

## Table VII-1
*Program Objectives and Measures of Effectiveness (not rank-ordered)*

Stabilization of Domestic Vaccine Supply

- Levels of vaccine production per population
- Number of vaccine producers
- Vaccine prices

Stabilization of High Vaccination Rates

- Rates of immunization

Ensuring Adequate Compensation for Adverse Reactions to Vaccines

- Comparison of compensation amounts with losses incurred
- Proportion of injured persons receiving compensation

Substituting Program for Litigation

- Frequency of claims against vaccine producers
- Comparison of vaccine surtax with litigation costs
- Availability of information on Program
- Availability of attorneys to represent petitioners
- Petitioners satisfaction with compensation awarded by Program
- Petitioners satisfaction with decisionmaking process and outcomes

Efficient Program Administration

- Level of compliance with petition/documentation requirements
- Proportion of petitions objected to
- Proportion of cases within Vaccine Injury Table
- Use of adversary and independent witnesses
- Proportion of awards appealed
- Time required for final decision
- Proportion of attorneys' costs covered by attorneys fee award
- Petitioners satisfaction with time, process, and participants
- Costs of administration
- Ratio of awards to trust funds

# RECOMMENDATIONS

The National Vaccine Injury Compensation Program (Program), 42 U.S.C. 300aa-10 et seq., is a federal no-fault compensation system for permanent injuries and deaths resulting from vaccines to prevent seven infectious diseases of childhood (diphtheria, tetanus, whooping cough, measles, mumps, rubella, and polio). State laws generally require that children be immunized against such diseases for school entry.

The Program, which became effective October 1, 1988, differs from most federal benefit programs in organizational structure and decisionmaking processes. Petitioners submit petitions for compensation to the United States Claims Court and bear the burden of proving both entitlement and the losses and expenses to be compensated. The Secretary of Health and Human Services (HHS) is designated as respondent. The National Vaccine Injury Compensation Program (NVICP) Office acts on behalf of the Secretary and may oppose compensation in individual cases.

Determinations of eligibility for and amounts of compensation are made by Special Masters within the United States Claims Court. There is no umbrella administrative agency charged with the duty of interpreting the enabling legislation or issuing general regulations. The Advisory Committee on Childhood Vaccines oversees the Program but is empowered only to advise the Secretary of HHS on Program implementation. The Secretary may revise the statutory list of compensable injuries (the Vaccine Injury Table), but has no authority to impose decisionmaking rules on the United States Claims Court.

## I. General Recommendations

### A. Program Evaluation

This hybrid programmatic structure was created to settle controversies over whether and how compensation should be awarded for adverse reactions to childhood vaccines. It was also intended to contribute to improving immunization rates, stabilizing the supply and price of vaccines, encouraging new and improved vaccines, and reducing the burden and uncertainty of litigation. If the decisionmaking process is effective in resolving a multi-faceted scientific and legal debate, it could be applied in other compensation or benefit programs, particularly those in which socially beneficial conduct is encouraged and the attendant risks are uncertain or controversial.

A long-term evaluation of the Program's operation and effects in the near future will be necessary to determine whether the Program could benefit from administrative changes and whether any of its elements could offer an efficient decisionmaking process in other areas. Congress recognized the need for evaluation and amended the statute in November 1989 to require the Secretary of HHS to evaluate the Program and report to Congress by January 1, 1992. The NVICP Office in HHS began planning for soliciting extramural proposals for such a study, but the solicitation process has not yet begun. It is unlikely that any well-designed new study could be conducted by the original deadline.

Several changes have already been made in the Program's decisionmaking authority and proceedings by statutory amendments. Experience with the Program has demonstrated that some problems are not easily anticipated and that others may be solved informally with relative ease as experience increases. For these reasons, new major or structural changes in the Program should be avoided until an objective evaluation of Program needs is completed.

### Recommendation 1. Longitudinal Program Evaluation

An empirical evaluation of the Program's operation and effectiveness during at least fiscal years 1990, 1991, and 1992 should be conducted to collect and analyze sufficient empirical data to determine whether the Program is meeting its objectives. Research questions to be addressed should also include whether the Program serves as an effective substitute for litigation, and the effectiveness of decisionmaking procedures. The evaluation should distinguish between the Program's handling of retrospective and prospective cases to identify effective or problematic administrative processes that may be peculiar to one or the other type of case.

## B. Opportunities to File Petitions with the Program

There have been anecdotal reports that some people who may be eligible for compensation for retrospective cases under the Program have failed to file petitions thereunder for lack of awareness of the Program's existence. The deadline for filing petitions with respect to vaccinations administered before October 1, 1988 (retrospective cases) was January 31, 1991. Because the Act requires petitioners to submit all available relevant evidence supporting their eligibility when the petition is first filed, potential petitioners need to be aware of Program requirements well before the limitations period for filing expires. In cases involving a vaccine administered on or after October 1, 1988 (prospective cases), failure to file a timely petition under the Program precludes the individual from filing a civil action for personal injuries arising out of the vaccination.

### Recommendation 2. Extension of Time for Filing Petitions

Congress should consider whether section 2116(a) of the National Childhood Vaccine Injury Act should be amended to extend the time for filing petitions with respect to a vaccine administered before October 1, 1988, to September 30, 1991 (36 months after the effective date of the Act), if necessary to ensure that all those eligible for the Program have an opportunity to file a petition if they wish.

### Recommendation 3. Program Information and Publicity

The National Vaccine Injury Compensation Program Office, in consultation with the United States Claims Court and the Advisory Commission on Childhood Vaccines, should explore effective ways to disseminate information about the Program, including eligibility requirements and the time within which petitions must be filed, throughout the country in order to ensure that the population is aware of its legal remedies.

## C. Conforming Time Limitations

Under the Act, petitioners with prospective cases may not commence a civil action for an injury arising out a vaccination covered by the Act unless they have filed a petition with the Program and elected not to accept the final judgment thereon or the decision on appellate review. The Act tolls the statute of limitations governing the civil action until a final judgment is issued on the petition. This tolling provision was intended to preserve a petitioner's right to commence a civil action after the petitioner had exhausted the remedies under the Act. However, because an election to accept or reject a decision may be made within 90 days after the final judgment issued by the United States Claims Court or a decision on appeal, there is a gap in the tolling provision that could extinguish a petitioner's right to commence a civil action.

### Recommendation 4. Conforming Time Limitations

Section 2116(c) of the National Childhood Vaccine Injury Act should be amended to stay the limitations of actions governing civil actions for personal injuries arising out of a vaccination covered by the Act until the date that the petitioner files an election, or is deemed to file an election, pursuant to section 2121 of the Act, to accept the judgment or to file a civil action.

## D. Determination of Eligibility

The major eligibility criterion entitling a petitioner to compensation under the Program is that an individual has sustained an injury (including death) that either is described in the Vaccine Injury Table within the time specified in that Table or that was caused by a covered vaccine. Petitioners bear the burden of proof on this issue. The Act also requires petitioners to submit all available documentation to sustain their burden on this issue. An award of compensation may be made only if a petitioner has demonstrated by a preponderance of the evidence that the injury is covered by the Act, and if the Special Master finds that there is not a preponderance of the evidence that the injury was caused by factors unrelated to the administrations of the vaccine. The Act does not assign the burden of proof of an alternative cause to either party to the proceeding. The respondent, however, ordinarily raises the issue when it thinks relevant. Since the respondent should have all information relevant to the determination of the cause of injury early in the proceedings and the Special Master can compel the production of any additional necessary information, the respondent ordinarily presents the case for an alternative cause. The time required for the Special Master to make a determination with respect to an alternative cause of injury might be reduced, especially in cases in which there is little controversy as to the cause of the injury, if the burden of proof of this issue were placed on the respondent. The respondent would not be under pressure to present expert opinion on the issue of causation in cases in which there was no dispute simply to create a record for the Special Master's determination. In effect, the issue would operate as an affirmative defense, which the respondent could raise in appropriate cases.

### Recommendation 5. Burden of Proof of Causation by Factors Unrelated to Vaccine

Section 2113(a)(1) of the National Childhood Vaccine Injury Act should be amended to require the respondent to carry the burden of proving that an injury or death described in any petition is due to factors unrelated to the administration of the vaccine. Compensation should be awarded if the special master or the United States Claims Court finds (1) that the petitioner has demonstrated eligibility for compensation by a preponderance of the evidence, and (2) that the respondent has not demonstrated by a preponderance of the evidence that the injury or death is due to factors unrelated to the administration of the vaccine.

### Recommendation 6. Independent Experts

If Recommendation 5 is not adopted, the Office of Special Masters should consider developing a list of independent experts to serve as expert witnesses in cases in which there is no clear preponderance of the evidence favoring either a Table injury or an injury caused by a covered vaccine, or favoring an unrelated cause of injury. Such experts should be generally recognized for their skill and knowledge and should not have any affiliation with any vaccine producer, government agency involved with vaccine research, approval, distribution, or evaluation, or regularly serve as an expert witness on behalf of a party in vaccine-related litigation. The types of cases in which the cause of injury or death is not readily resolved by evidence introduced by the parties should be studied to predict whether and how often such independent experts might prove useful and whether they could in fact assist in creating a fair and expeditious decisionmaking process.

## E. Determinations of Compensation

Compensation for permanent injury, other than death, includes the net present value of actual unreimbursable expenses for medical, rehabilitative, and custodial care, actual and anticipated lost earnings, and actual and projected pain and suffering. The determination of the amount of compensation to be awarded to eligible petitioners in cases of injury can be difficult and time consuming. To expedite calculation of the amounts to be paid and to promote their consistency across similarly situated individuals, the Special Masters could apply uniform discount rates to the elements of compensation. This should reduce the need for hearings or submissions to prove future inflation rates to establish the net present value of specific elements of compensation.

### Recommendation 7. Measures of Net Present Value of Compensation

The Office of Special Masters, in consultation with the Advisory Commission on Childhood Vaccines and the National Vaccine Injury

Compensation Program Office, should develop uniformly applicable measures, such as discount rates for the value of medical and other services to be purchased in different years, for calculating the net present value of specific elements of compensation to be awarded to petitioners. Such measures could be applied in all cases to compute the amount of awards promptly and with consistency in cases similarly situated. The measures should be reviewed at least annually in order to ensure that they are consistent with reasonable estimates of future economic performance.

## F. Settlement Authority

The expeditious settlement of an injury case is sometimes hampered by limitations on the authority of attorneys in the Department of Justice (DOJ) who represent the respondent in the Program to settle cases for more than a specific amount of compensation. The limitation is lower than the average award to an eligible petitioner in an injury case. The time required to obtain approval of a settlement may jeopardize compliance with the Act's deadline for the Program's final decision.

### Recommendation 8. DOJ Settlement Authority

The Department of Justice should grant to the chief of the Vaccine Injury Compensation Program section authority to settle cases of injury under the Program in which the compensation award does not exceed $1.5 million.

## II. Interim Measures to Ease Temporary Program Burdens

The Program's capacity to make expeditious decisions is being strained temporarily as a result of the recent filing of more than 3,000 petitions during the 5 months preceding February 1991. This represents about 10 times the number filed in the preceding 2 years. The vast majority of these petitions are retrospective cases representing injuries from vaccinations administered at any time before October 1, 1988. The unusual burden they place on the Program is unlikely to extend to prospective cases brought after January 31, 1991. Prospective cases are expected to be filed in smaller numbers each year and in a more regular pattern because they must be brought within 2 to 4 years after the injury.

The bulge of retrospective cases now in the Program warrants a special response to ease the burden of deciding petitions. Steps should be taken to expedite the decisionmaking proceedings. Even so, the time needed to make final decisions in this group of cases is likely to extend well beyond the 240 days (plus extensions) now required by the Act. Because the limit is jurisdictional, as a result of a 1990 amendment to the Act, petitions that are not decided within the time limit are dismissed and the petitioners are precluded from proceeding within the Program. To the extent that such petitioners pursue civil actions for the same injuries, one purpose of the Program--to serve as a substitute for litigation--would be undermined.

Existing resources are unlikely to prove adequate to process the temporary bulge of retrospective cases. Therefore, if these cases are to be decided within the next 2 to 4 years, additional Special Masters will be required to serve as decisionmakers for the Program, and the Departments of HHS and Justice may need to obtain additional staff to review petitions and represent the NVICP Office before the United States Claims Court.

## Recommendation 1. Deletion of Involuntary Dismissal for Exceeding Time Limits

Congress should delete section 2121(b)(2) of the National Childhood Vaccine Injury Act, as added by the Vaccine and Immunization Amendments of 1990, which withdraws jurisdiction over any petition that is not decided within the time required by the Act.

## Recommendation 2. Extension of Time to Decide Claims

Congress should amend section 2112(d)(3) of the National Childhood Vaccine Injury Act, as amended by the Vaccine and Immunization Amendments of 1990, to permit the chief special master to suspend proceedings on and to extend the time for deciding all or any petitions under the Program for up to 2 years, in addition to all other extensions and suspensions permitted, when the chief special master determines that the number of filings and resultant workload so requires in the interest of justice.

## Recommendation 3. Number of Special Masters

Congress should amend section 2112(c)(1) of the National Childhood Vaccine Injury Act to increase the maximum number of special masters from 8 to 12.

## Recommendation 4. Aids to Interpretation

Congress should consider whether additional qualifications and aids to interpretation of the Vaccine Injury Table, set forth in section 2114(b) of the National Childhood Vaccine Injury Act should be adopted to further clarify and explain the symptoms and conditions that should be considered evidence of an injury described in the Table, to simplify the process of determining eligibility.

## Recommendation 5. Compensation Fund Advisor

The National Vaccine Injury Compensation Program Office in the Department of HHS should engage an advisor to the Trust Fund who could assist in calculating the net present value of elements of compensation and in identifying reasonable sources, kinds, and amounts of annuities and other methods for the payment of awards.

## Recommendation 6. Compensation Guidelines

The United States Claims Court, in consultation with the National Vaccine Injury Compensation Program Office and representatives of petitioners, should develop guidelines for the amount of compensation payable with respect to each element of compensation. The guidelines should provide for appropriate variations on the basis of age, severity of injury, intensity of services, and other relevant factors. The guidelines should present a range of values in each category, with flexible ceilings and floors, in order to accommodate special circumstances. The special masters should provide petitioners and respondent with a copy of the relevant guidelines to facilitate the expeditions calculation of compensation. Requests for compensation within the relevant range could be presumed acceptable in the absence of evidence demonstrating that the petitioner's needs are more likely than not to be outside the guidelines.

# EPILOGUE

The National Vaccine Injury Compensation Program (Program) has experienced a new challenge since those described in the Report. In September 1990, the last month for filing petitions for retrospective injuries, about 2,700 petitions were submitted to the U.S. Claims Court, or more than five times the total number filed in the preceding 23 months. Another 700 retrospective petitions were submitted after the October 1, 1990 deadline, and returned by the court for lack of timeliness. The unexpected avalanche of cases helped to persuade Congress to extend the deadline for filing retrospective petitions. In November 1990, President Bush signed into law amendments to the Act that, among other things, extended the deadline for filing petitions for retrospective injuries to January 31, 1991.[194] By the end of January 1991, the Program had received 4034 retrospective petitions and 98 prospective petitions. About 800 retrospective petitions were filed in the month of January alone.

The increased number of cases has created two new problems for the Program. One is concern that the funds appropriated for retrospective cases will be insufficient to pay awards as permitted by the Act. The second is concern that the time required to decide claims will exceed the limits established in the amended Act. Both of these are summarized briefly below.

## Awards in Retrospective Cases

The Report indicated that the average award paid to a petitioner for a retrospective injury was approximately $1 million as of February 28, 1990. Awards in the case of death were limited to the statutory maximum of $250,000. By January 21, 1991, the Program had issued final decisions awarding $87.8 million in 136 cases, including two prospective death cases. Awards in retrospective cases of injury ranged from $86,000 to $2.9 million, with an average of $1.2 million.

While predictions of the cost of awards that will be made in all retrospective cases are necessarily tenuous, it is likely that they will exceed substantially the $400 million that Congress has authorized for retrospective cases. If awards were made in 71 percent of the 4,034 retrospective cases filed, as they were through February 28, 1990, and in the same ratio of approximately two death cases for every injury case, then total retrospective awards could be made for 955 injuries and 1,909 deaths. This would require

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[194] Vaccine and Immunization Amendments of 1990, Pub. L. No. 101-502, sec. 5(e), 104 Stat. 1285.

$1.1 billion (955 x $1.2 million) for injuries and $477 million (1,909 x $250,000) for deaths, for a cumulative cost of $1.6 billion, or four times the amount authorized to be appropriated.

This estimate, however, is both too conservative and too liberal. The number of petitions alleging injury rather than death has risen in recent months, so that the proportion of awards for injury is likely to be higher than that seen during the first year of the Program. For example, only about 300 of the 2,700 petitions filed in September 1990 sought compensation for death. Thus, it may be more realistic to estimate the ratio of death to injury cases as 1:6, which is closer to the estimated incidence of vaccine related deaths and injuries nationally. Using this ratio, of the 4,034 petitions filed, approximately 576 could involve death, while 3,458 could involve injury. This would increase the cost of awards for injury, since injury awards are four to eight times as large as awards for death.

At the same time, it seems unlikely that the Program will approve the same high proportion of petitions that it did during the first year. During the first few months of 1991, only about 60 percent of petitions were approved, and this could decrease further. Assuming that only 50 percent of all petitions (2,017) were awarded compensation, a total of $2.1 billion could be required to fund all such retrospective awards ($72 million for death cases and $2.07 billion for injuries cases).

These are very crude estimates and need refinement with more complete data. The range of $1.6 to $2.1 billion in total costs is consistent with an earlier rough estimate of $2 billion made by the U.S. Claims Court Office of Special Masters. This represents eight times the total funds actually appropriated by Congress for retrospective cases so far. If the Program is to pay out awards to all eligible petitioners, something must change. The number of awards may decrease, the proportion of awards for injuries may decrease, the amount awarded per petitioner may decrease, Congress may appropriate more money to fund retrospective awards, or other sources of funds may become available.[195]

## Time to Determine Claims

The Report on the Program's first year noted that the time required to assess and determine the amount of compensation to be awarded to successful petitioners in injury cases was occupying an increasing proportion of the claims determination process. This trend has continued. The Office of Special

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[195] For example, the Act permits the Trust Fund to seek subrogation from parties responsible for injuries for which an award has been made. 42 U.S.C. 300aa-17.

Masters reports that compensation determination consumes about half the time required to decide claims. The time appears to be spent largely by the petitioners and the respondent seeking expert assessments of the future costs of medical and rehabilitative care for injured children, eligibility for federal and state assistance, present values of future living and medical expenses, and calculating appropriate annuities. In a significant proportion of cases, the amount of compensation is contested, even when there is no real dispute over eligibility.

Given the large numbers of new retrospective claims, the Program is already experiencing difficulty handling the petitions within statutory time limits. The number of staff that was sufficient to process 300 petitions in mid-1990 is not likely to be able to decide 4,000 new claims in the same timeframe. The Office of Special Masters, for example, had six special masters in August 1990. It is now actively recruiting two additional special masters to return to its original total of eight. But, it is limited to eight special masters by the amended Act. The Program Office within the Department of Health and Human Services and attorneys in the Department of Justice (DOJ) are similarly understaffed. It is possible that the Program Office and the DOJ may feel compelled to withdraw from participating in some cases, as they did in May 1989. Yet, their withdrawal would not eliminate the need for determining awards for successful petitioners.

Several options exist to minimize the time pressure faced by the Program. The most obvious is to amend the statute to extend the time for reaching a final decision in retrospective cases. The November 1990 amendments to the act added a new provision permitting the Chief Special Master to "suspend proceedings on any petition for up to 180 days in addition to the suspension time" already permitted by the Act, if the workload created by the number of petitions created an "undue burden."[196] In the absence of increases in Program staff, the extension period might need to be longer than 6 months, even a year. A lengthy extension, however, may undermine one of the Program's greatest attraction to petitioners--its speed.

A second option is to increase the number of staff at all three entities involved in the Program. This would require additional appropriations to fund new staff, adding more costs to the Program. It would also require amending the Act to permit more than eight special masters. However, authorization and recruitment of new reviewing physicians for the Program Office and new DOJ attorneys could take several months. Cases being processed during that period are likely to need an extension of time for decision.

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[196] Vaccine and Immunization Amendments of 1990, Pub. L. No. 101-502, sec 5(b)(1), amending 42 U.S.C. 300aa-12(d)(3). The Amendments also permit a petitioner, upon 30-days' notice to the court, to withdraw a petition if it is not finally decided within the 240-day time limit (plus extensions). Moreover, if a decision is not made within 30 days after such notice is filed, the petition is deemed withdrawn. Thus, the Program would no longer apply in any case in which a decision could not be made within the statutory time limits. A petitioner who withdraws a petition under these circumstances may pursue litigation.

A third option is to establish more uniform standards of compensation for eligible petitioners with injury cases to reduce the time required to calculate awards. This could be accomplished in several ways. The simplest, least attractive to petitioners, and probably least equitable, would be to establish a fixed dollar amount for all injuries, as the British Vaccine Damage Payments Act does.[197] An alternative would be to establish a fixed dollar amount for each type of injury, based on average estimates of future medical and rehabilitation expenses. More elaborate schedules of compensation are also possible, with fixed amounts specified for particular ages, conditions, geographic locations, and insurance status. These can be tailored to individual circumstances without extensive investigations of individual needs. Scheduled compensation has the advantage of permitting special masters to award compensation without extensive hearings on damages. It may also eliminate the need for the Program to pay the costs of expert witnesses for individual petitioners. Scheduled compensation also has disadvantages. It would require several months at best to develop a reasonable schedule. It is not likely to appeal to petitioners. Most troublesome, it materially alters the Act, which provides for compensation of actual estimated future expenses to all eligible petitioners who have already filed a petition. Thus, it would require an amendment to the statute, and an opportunity for those who do not want scheduled compensation to opt out of the Program and pursue litigation. The implications of such a change, for the Program, the supply of vaccines, and immunization in general are not easily predictable. Similar standards in the form of nonstatutory guidelines, however, could be used by the special masters without amending the Act.

An alternative to fixed or scheduled compensation is a procedural device known as "final-offer adjudication." The special masters could require both the petitioner and the respondent each to submit one first-and-final statement of the compensation thought appropriate and the special master would choose one or the other as the final award. A similar statutory decision rule in Wisconsin's workers compensation program governs decisions on disability ratings and requires the administrative law judge to make a determination within 5 percent of either rating.[198] Splitting the difference is not permitted, so extreme estimates by partisan experts is discouraged. Such an approach could be required by amending the statute or implemented by the special masters. It would save time, although the parties would still have to spend considerable effort developing a realistic estimate.

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[197] If the $400 million in authorized funds were spread equally among 2,000 eligible applicants, each could receive $200,000. Since more than $88 million has already been awarded, only about $312 million is available for the remaining eligible petitioners, who could number almost 2,000. That would permit approximately $165,000 per person, less than the $250,000 Act provides in death cases. The British Vaccine Damage Payments Act pays 20,000 pounds to an eligible claimant, but the amount, which has been criticized as woefully inadequate, is not intended as compensation. Mariner, *Compensation Programs for Vaccine–Related Injury Abroad: A Comparative Analysis*, 31 ST. LOUIS L.J. 599, 626 (1987).

Finally, it might be possible to eliminate much of the immediate decisionmaking with respect to long-term care by making successful petitioners eligible for institutional or home care services under the Medicare or Medicaid programs. This would enable petitioners to obtain services as and when needed in future years, without necessitating an estimate of total lifetime costs. Moreover, it would reduce the current pressure on Program funds. Medicare appears to be attractive because it already offers assistance to some disabled persons, and, like the Program, is federally administered. However, it is not structured to provide general nonacute care, and would require an amendment to authorize eligibility for appropriate services for petitioners. Medicaid programs do cover some long-term care. But because Medicaid is administered by the states, consistent coverage for Program petitioners could not be assured without some federal intervention. The statute would also require amendment to permit appropriate home care services.

The options sketched above are merely suggestive of the types of responses available. It will be important to ensure that any alteration of the existing statutory scheme be consistent with the original goals of the Program and that they garner the general support that made the Program possible.

## Conclusions

Just as the Program was setting into a more comfortable mode of operation, a large influx of petitions has necessitated reconsideration of the decisionmaking process. The new petitions seem to confirm the appeal of and need for the Program. Thoughtful consideration is required to develop ways to decide a larger number of claims without losing the benefits of the Program.

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[198] L. I. Boden, REDUCING LITIGATION: EVIDENCE FROM WISCONSIN (1988).

### Report for Recommendation 91-5

# The Labor Board's First Rulemaking: An Exercise in Pragmatism

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This report was prepared for the consideration of the Administrative Conference of the United States. The views expressed are those of the author and do not necessarily reflect those of the members of the Conference or its committees except where formal recommendations of the Conference are cited.

# I. Introduction

Despite having been granted both rulemaking and adjudicatory power in its statutory charter more than half a century ago,[1] the National Labor Relations Board has chosen to formulate policy almost exclusively through the process of adjudication.[2] The Board's commitment to this single method of policy formulation has seemed impenetrable. Decades of critical commentary,[3] frequent prodding from reviewing courts,[4] and legislative proposals[5] for mandatory rulemaking had no apparent affect. Even as rulemaking eclipsed adjudication as the preferred method for policymaking among major federal agencies the Board steadfastly clung to the quasi-judicial approach, almost as a necessary tenet of regulation of labor-management relations. It seemed the Board was one federal agency that would never be persuaded of the virtues of notice-and-comment rulemaking.

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[1] "The Board shall have the authority from time to time to make, amend, and rescind in the manner proscribed by the Administrative Procedure Act, such rules and regulations as may be necessary to carry out the provisions of this Act." 29 U.S.C. 156.

[2] The Board used rulemaking to establish jurisdictional standards for private colleges and universities and for symphony orchestras. It also used rulemaking in deciding not to assert jurisdiction over the horse racing industry. See, 2 C. Morris, *The Developing Labor Law* 1631 nn. 214-16 (2d ed. 1983).

[3] Morris, *The NLRB in the Dog House--Can an Old Board Learn New Tricks?*, 24 SAN DIEGO L.R. 9 (1987); Estreicher, Policy Oscillation at the Labor Board: A Plea for Rulemaking, in proceedings of NYU 37th Annual National Conference on Labor (1984), reprinted in 37 AD. L. REV. 163 (1985); Subrin, Conserving Energy at the Labor Board: *The Case for Making Rules on Collective Bargaining Units*, 32 LAB. L.J. 105 (1981); Silverman, *The Case for the National Labor Relations Board's Use of Rulemaking in Asserting Jurisdiction*, 25 LABOR L.J. 607 (1974); Kahn, *The NLRB and Higher Education: The Failure of Policymaking through Adjudication*, 21 U.C.L.A. L. REV. 63 at 167-175 (1973); Bernstein, *The NLRB's Adjudication-Rulemaking Dilemma Under the Administrative Procedure Act*, 79 YALE L.J. 571 (1970); Peck, *A Critique of the National Labor Relations Board's Performance in Policy Formation: Adjudication and Rule Making*, 117 U. PA. L. REV. 254 (1968); Shapiro, *The Choice of Rulemaking or Adjudication in the Development of Administrative Policy*, 78 HARV. L. REV. 921 (1965); Peck, *The Atrophied Rule Making-Powers of the NLRB*, 70 YALE L.J. 729 (1961). But see, Note, *NLRB Rulemaking: Political Reality Versus Procedural Fairness*, 89 YALE L.J. 982 (1980).

[4] See, e.g., NLRB v. Res-Care, Inc., 705 F.2d 1461, 1466 (7th Cir. 1983); NLRB v. Majestic Weaving Co., 355 F.2d 854, 860 (2d Cir. 1966); see also NLRB v. Wyman-Gordon Co., 394 U.S. 759, 764 (1969).

[5] Provisions of the proposed Labor Law Reform Act of 1978 would have encouraged the Board to make greater use of rulemaking. See, S. Rept. No. 95-628, 95th Cong., 2d Sess. 18-20 (1978).

Then on July 2, 1987, these startling words appeared in the Federal Register:

> In order to facilitate the election process, the National Labor Relations Board proposes to amend its rules to include a new provision specifying which bargaining units will be found appropriate in various types of health care facilities. The Board has resolved to utilize notice-and-comment rulemaking rather than be presented with continuing lengthy and costly litigation over the issue of appropriate bargaining units in each case. Interested parties may submit oral testimony in connection with the proposed rules.[6]

A little over 2 years later the Board published a final rule governing bargaining unit determinations in health care facilities.[7] The Board's institutional resolve to avoid substantive rulemaking appeared to have collapsed, and it was possible to imagine wide-ranging and vigorous use of this previously dormant policymaking device.

This case study seeks to document that event, evaluate its significance, and identify aspects of the experience that suggest need for possible reform.[8] The challenge of the exercise lies in balancing an understanding of the uniqueness of the policy problem that triggered and was dealt with in the rulemaking with an appreciation of the richness of this experience as a guide to possible broader use of rulemaking by the Board.

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[6] Collective-Bargaining Units in the Health Care Industry, 52 Fed. Reg. 25,142 (1987) (Notice of Proposed Rulemaking, July 2, 1987)[hereinafter NPR I].

[7] Collective-Bargaining Units in the Health Care Industry, 54 Fed. Reg. 16336 (1989) (Notice of Final Rule, April 21, 1989)[hereinafter Final Rule].

[8] As part of the study, the author conducted in-person and telephone interviews with agency officials, members of the labor-management bar, and representatives of affected parties, including labor organizations, who participated in the rulemaking. The author's description of certain aspects the rulemaking is drawn from these interviews collectively, but no part of the description is intended as a reflection of the views of any individual interviewee. [hereinafter Interviews].

The following persons were interviewed:

James M. Stephens, Chairman, National Labor Relations Board; Mary Miller Cracraft, Member, National Labor Relations Board; Dennis M. Devaney, Member, National Labor Relations Board; Clifford R. Oviatt, Jr., Member, National Labor Relations Board; John E. Higgins, Solicitor, National Labor Relations Board; John C. Truesdale, Executive Secretary, National Labor Relations Board; Linda Sher, Assistant General Counsel, National Labor Relations Board; Berton Subrin, Director, Office of Representation Appeals, Sandra Elligers, Attorney, Office of Representation Appeals, Bernard Ries, Administrative Law Judge, National Labor Relations Board; Thomas P. Burke, Co-Chair, Committee on National Labor Relations Board Practice and Procedure, American Bar Association Section on Labor Law; Lawrence B. Miller, Co-Chair, Committee on National Labor Relations Board Practice and Procedure, American Bar Association Section on Labor Law; David A. Grant, Chair, Labor and Employment Law Committee, American Bar Association Section on Administrative Law and Regulatory Practice; Jerry Goldman, Victor Schacter.

## II. The Choice Between Rulemaking and Adjudication: Generally

The Board's historic resistance to rulemaking as an instrument of policymaking forms an important part of the more general issue of the degree of discretion of administrative agencies to choose between rulemaking and adjudication and the legal and policy consequences of that choice.[9] The need for discretion in choice between the two modes of procedure was acknowledged by the Supreme Court in relatively broad terms in the context of the Public Utility Holding Company Act in *SEC v. Chenery Corp.*[10] *(Chenery II)*:

> Since the Commission, unlike a court, does have the ability to make new law prospectively through the exercise of its rule-making powers, it has less reason to rely upon *ad hoc* adjudication to formulate new standards of conduct with the framework of the Holding Company Act. The function of filling the interstices of the Act should be performed, as much as possible, through this quasi-legislative promulgation of rules to be applied in the future. But any rigid requirement to that effect would make the administrative process inflexible and incapable of dealing with many specialized problems that arise.... Not every principle essential to the effective administration of a statute can or should be cast immediately into the mold of a general rule. Some principles must await their own development, while others must be adjusted to meet particular unforeseeable situations. In performing its important functions in these respects, therefore, an administrative agency must be equipped to act either by general rule or by individual order.

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[9] Berg, *Reexamining Policy Procedures: The Choice Between Rulemaking and Adjudication*, 38 ADMIN. L. REV. 149 (1986). See also, Bonfield, *State Administrative Policy Formulation and the Choice of Lawmaking Methodology*, 42 ADMIN. L. REV. 121 (1990).

[10] 332 U.S. 194 (1947).

> To insist upon one form of action to the exclusion of the other is to exalt form over necessity.[11]

By the time of *Chenery II* in 1947, the Labor Board had, in its first 12 years of operation, established a firm commitment to adjudication. In this period, the substance of the Board's policymaking, the agency structure for decisionmaking, and the scope of judicial review of its decisions were subjects of controversy. The Board's exclusive reliance on adjudication was of little interest. The Taft-Hartley Act of 1947 reaffirmed the Board's rulemaking authority and made such action subject to the Administrative Procedure Act, but apparently this amendment was neither intended nor understood to encourage the Board to make greater use of that authority.

Over the next two decades, the use of rulemaking in major federal agencies grew, and a body of commentary and judicial opinion encouraging and approving this move developed. In turn, the policy considerations that underlay *Chenery II* came into sharper focus and ultimately the issue shifted to the question of limits on agency discretion to choose. Agency power to use rulemaking authority to resolve by general principle issues that recurred in adjudicatory hearings was broadly asserted and approved.[12] Gains in administrative efficiency through the use of general rules were frequently seen as outweighing the previously assumed superiority of policy evolved incrementally through case-by-case consideration. At the same time, rulemaking was acknowledged to offer broader opportunity for public participation and more meaningful notice to affected parties of regulatory standards. The efficiency and fairness arguments supporting agency choices of rulemaking generally carried the day.[13] The controversy centered instead on the choice of adjudication. Here, the long-standing exclusive of reliance of Board on adjudication tested the limits of the discretion conferred by *Chenery II*.

Concern with the Board's refusal to use its rulemaking authority for substantive matters drew criticism in 1958 from the American Bar Association's Labor Law Section. The Section recommended that the Board reconsider its position that the promulgation of certain of its most rule-like policies do not require compliance with the rulemaking procedures of the

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[11] 332 U.S. at 202-03.

[12] See, United States v. Storer Broadcasting Co., 351 U.S. 192 (1956). See also, American Airlines, Inc., v. Civil Aeronautics Board, 359 F.2d 624 (D.C. Cir. 1966); WBEN, Inc. v. 396 F.2d 601 (2d Cir. 1968), *cert. denied* 393 U.S. 914 (1968).

[13] See National Petroleum Refiners Association v. Federal Trade Commission, 482 F.2d 672 (D.C. Cir. 1973).

Administrative Procedure Act.[14] A few years later in a seminal work on the subject, Professor Cornelius Peck broadly challenged the Board position that its work inherently demanded an adjudicatory approach and urged the Board to undertake rulemaking for a portion of its work.[15] Over the next several years, a series of actions at the Board culminated in a Supreme Court decision addressed specifically to the question of whether a policy announced in the course of an adjudication was in fact a "rule" requiring compliance with the APA for its promulgation.

In *NLRB v. Wyman-Gordon Co.*,[16] a divided Court upheld the application of a rule-like policy announced, but not applied, in an adjudication against one party to different party in a subsequent proceeding. A majority of the Court, however, through several separate opinions, expressed disapproval of the Board's disregard of the APA procedures for rulemaking, particularly in light of the Board's decision in the original adjudication to apply the policy only prospectively. *Wyman-Gordon* was generally interpreted as signaling the Court's intention to more closely scrutinize the Board's avoidance of the rulemaking process.[17] The unusual division of opinions in the case, however, left unclear how the more intense scrutiny might be accomplished consistent with the discretion accorded by *Chenery II*. Within less than 5 years a case reached the Court in which a Court of Appeals had sought to apply the admonitions of *Wyman-Gordon* in reviewing a new Board policy formulated in an adjudication. Rebuffing the panel's effort, the Court in *NLRB v. Bell Aerospace* Co.,[18] unanimously reaffirmed the application of *Chenery II*. The court sustained the Board's application of the "managerial employee" exemption to certain industrial buyers. It observed: [19]

> The views expressed in Chenery II and Wyman-Gordon make plain that the Board is not precluded from announcing new principles in an adjudicative proceeding and that the choice between rulemaking and adjudication lies in the first instance within the Board's discretion. Although there may be situations where the Board's reliance on adjudication would

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[14] 42 Lab. Rel. Rep. 492 (1958). The recommendation, approved by the House of Delegates, provided that "[t]he Board should reconsider its view that its decisional policies on such matters as jurisdictional standards and contract-bar rules do not come within the rule-making requirements of the Administrative Procedure Act. Id. at 513.

[15] Peck, *supra* note 3.

[16] 394 U.S. 759 (1969).

[17] See Bernstein, *supra* note 3 at 571.

[18] 416 U.S. 267 (1974).

[19] 416 U.S. at 294.

> amount to an abuse of discretion or a violation of the Act, nothing in the present case would justify such a conclusion. Indeed, there is ample indication that adjudication is especially appropriate in the instant context.... [D]uties of buyers vary widely depending on the company or industry. It is doubtful whether any generalized standard could be framed which would have more than marginal utility. The Board thus has reason to proceed with caution, developing its standards in a case-by-case manner with attention to the specific character of the buyers' authority and duties in each company. The Board's judgment that adjudication best serves this purpose is entitled to great weight.
>
> The possible reliance of industry on the Board's past decision with respect to buyers does not require a different result. It has not been shown that the adverse consequences ensuing from such reliance are so substantial that the Board should be precluded from reconsidering the issue in an adjudicative proceeding. Furthermore, this is not a case in which some new liability is sought to be imposed on individuals for past actions which were taken in good-faith reliance on Board pronouncements. Nor are fines or damages involved here.

Thus, *Wyman-Gordon*, and *Bell Aerospace* constrain only modestly the discretion of the Board to choose between rulemaking and adjudication. While the announcement, but not the application, of a new policy in an adjudication or harsh retroactive effects from an policy formulated and applied in an adjudication may trigger closer judicial scrutiny, the Court has remained largely faithful to the *Chenery II* view that flexibility in choice of mode of procedure is an essential attribute of administration.

## III. The Board's Choice of Mode of Procedure

While *Wyman-Gordon* and *Bell Aerospace* address the formal limits of the Board's exercise of discretion in the choice of procedural mode, concern with the practical implications of the Board's preference for adjudication in the accomplishment of its regulatory mission more closely captures the essence of the ongoing controversy. Broadly stated, these concerns are: (1) the form and nature of the data upon which Board policy is based, (2) the openness of the policymaking process, (3) the clarity of Board policy, (4) the stability of Board policy, and (5) the efficiency of the policy enforcement process.[20] Each of these concerns is independently quite complex and that complexity is compounded by relationships among them. For present purposes, a synthesis, rather than an elaboration, of them is more likely to be helpful.

The policy product of Board adjudications broadly takes two forms. First, there are cases which, in the common law mode, involve application of established policy to particular facts. Cases of this kind, because of subtle changes over time, represent an evolutionary, incremental form of policymaking. Second, there are cases which, more in a legislative mode, are used by the Board as vehicles to announce more drastic policy change without much regard to the particular facts. When proceeding in the latter mode the essence of the policy product is indistinguishable from the product of a rulemaking. The policy may be an extremely precise rule that in future cases requires only mechanical application or it may be vague, open-ended rule that only sets the general contours by which future cases are to be decided. The particularity of the policy in one instance or the generality of it in another may have important enforcement implications, but either kind of policy formulated in this fashion shares an important feature. It is formulated exclusively from *argument* and *evidence* that the *parties* to the proceeding offer (evaluated in light of the Board's expertise). Consequently it formally lacks as a basis the breadth of data that rulemaking submissions can provide and, even the data upon which it is based is presented by a limited number of participants.[21] The seriousness of these shortcomings is then a critical issue in evaluating the choice not to use notice-and-comment rulemaking in cases taking this form. Cases taking the traditional common law form raise no such questions and would arise even where true rules requiring more than mechanical application were in place.

The breadth and sources of the data for policymaking are, thus, both an obvious and a fundamental concern. Concern with policy clarity and stability is more subtle and perhaps peripheral. Because the line between the two forms of adjudication described above is not always clear, important policy changes can be lost (or hidden) in the reasoning process of adjudication. Similarly, the opportunity exists for unanticipated policy shifts, unanticipated both in the sense of limited notice of the prospect of change and in the volatility of existing policy majorities in the face of changes in Board membership. Rulemaking thus provides clarity not in the sense of the specificity of policy (which may vary from rule to rule) but in the identification of a decision as a policy choice. Likewise, it provides stability, not in the sense of unchangeable policy, but in policy that can not be changed without a process focused on the policy choice.

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[20] See generally, Morris, Estriecher, and Peck, *supra* note 3.

[21] In adjudications which raise unusually important policy questions, the Board often schedules oral argument and invites amicus curiae participation by representatives of the affected labor and management organizations. While this procedure clearly does not satisfy the notice-and-comment requirement of the Administrative Procedure Act, it does broaden participation beyond the immediate parties in the adjudication and typically includes the affected organizations most likely to participate in a rulemaking.

Finally, the efficiency of the enforcement process is implicated by the policymaking procedure used. To the extent that a rulemaking can lay to rest important policy issues that would require a series of adjudications over a long period of time, enforcement is advanced. Moreover, the policymaking agenda can be set internally with a view toward enforcement needs, rather than externally in the form of cases parties choose to press. Nevertheless, much of the value remains dependent upon time and resources consumed by the rulemaking and the form of the rulemaking product.

## IV. The Choice for Rulemaking: Health Care Bargaining Units

The Board's choice of health care bargaining units for its first major rulemaking is inextricably intertwined with the agency's struggle with this subject for nearly 15 years after the passage of the Health Care amendments to the National Labor Relations Act in 1974.[22] It is necessary therefore to consider preliminarily, but briefly, background of the substantive issue the Board chose to deal with through rulemaking.

### A. The 1974 Health Care Amendments to the NLRA

In the early years of the Act, the Board asserted jurisdiction over nonprofit hospitals.[23] The Taft-Hartley amendments of 1947 reversed that decision excluding such institutions from the definition of "employer."[24] Thereafter the Board made consistent the status of hospitals under the Act by refusing to assert jurisdiction over proprietary hospitals.[25] In 1967 the Board reversed course and asserted jurisdiction over proprietary hospital,[26] leaving only nonprofits statutorily excluded. The Health Care amendments to the Act in 1974, finally settled the question of coverage for all hospitals by repealing the statutory exclusion for nonprofits. Thus, after 1974 health care institutions became subject to Board jurisdiction without regard to their status as proprietary or nonprofit.

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[22] 29 U.S.C. 151 (1947), et seq., as amended by Act of July 26, 26, 1974, Pub. L. No. 93-360.

[23] Central Dispensary and Emergency Hosp., 57 N.L.R.B. 393 (1943), *aff'd* 145 F.2d 852 (D.C. Cir. 1944), *cert. denied*, 324 U.S. 847 (1945).

[24] The legislation amended the section 2(2) definition of employer to exclude "any corporation or association operating a hospital, if no part of the net earnings inures to the benefit of any private shareholder or individual." 29 U.S.C. §152(2) (1947). See generally, J. Abodeely, R. Hammer & A. Sandler, *The NLRB and the Appropriate Bargaining Unit* 249-50 (rev. ed. 1981).

Apart from resolving the coverage issue, the 1974 amendments included several provisions governing labor-management relations in the health care fields. One such provision that was proposed, but not enacted, would have limited the Board to finding appropriate in the health industry only four bargaining units: (1) a unit of all professionals, (2) a unit of all technical employees, (3) a unit of all clerical employees, and (4) a unit of all maintenance and service employees.[27] This proposal was based on the view, propounded by health care employers, that Board unit determinations based upon a more refined analysis of the myriad occupational categories in the typical hospital would create an unacceptable degree of fragmentation for purposes of collective bargaining. Smaller units, in this view, would raise health care costs and jeopardize patient care by increasing the number and scope of strikes, stimulating jurisdictional disputes, and promoting whipsaw tactics in bargaining.[28]

Despite the vigorous lobbying of health care employers led by the American Hospital Association, this proposal was rejected, leaving unchanged the Act's provisions on bargaining unit determinations. Nevertheless, both the Senate and House expressed solicitude for the employers' concern by including a statement in their respective committee reports that "[d]ue consideration should be given by the Board to preventing proliferation of bargaining units in the health care industry." For the next 15 years, enormous resources of health care employers and unions, as well of the Board, were devoted to reconciling the Board's traditional discretion in the unit determination area with this piece of legislative history.

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[25] Flatbush General Hospital, 126 N.L.R.B. 144 (1960).

[26] Butte Medical Prop., 168 N.L.R.B. 266 (1967).

[27] S. 2292, 93d Cong., 2d Sess. 1974.

[28] Coverage of Nonprofit Hospitals Under National Labor Relations Act: Hearing on S. 794 and S 2292 Before the Subcomm. on Labor of the Senate Comm. on Labor and Public Welfare, 93d Cong., 1st Sess. (1973).

## B. The Nonproliferation Issue and Unit Politics

Unit proliferation became a troublesome issue in health care cases not only because the concern raised by the industry in the legislative process had been addressed only obliquely through an agreed statement in legislative history, but also because the unit determinations in general involve high stakes. Put most simply, larger, more heterogenous units are harder to organize than smaller, more homogeneous ones. Representation elections are frequently won and lost on the basis of the Board's unit determination. Labor relations thereafter are also profoundly affected by the employee configurations established.

It is not surprising then that hospitals pressed the view that the legislative history statement, which became known as the "nonproliferation mandate," was intended as a congressional direction to the Board to confine itself, to the greatest extent practical, to the four units specified in the failed legislative provision. Nor was it surprising, that health care unions strenuously resisted this construction of the legislative events, urging instead that the Board pursue its traditional "community of interest" analysis in making unit determinations. That division of views led to highly contentious litigation before the Board and the Court of Appeals and over time produced policy conflict within the Board and division in the circuits. The history of this litigation is lengthy and complex,[29] but its essence for current purposes can be captured by considering the Board's general approach to unit questions along with a few illustrations specific to the health care industry.

Section 9(a) of the Act provides that representation of employees for purposes of collective bargaining shall occur "in a unit appropriate for such purposes." Section 9(b) provides that the Board "shall decide in each case whether, in order to assure to employees the fullest freedom in exercising the rights guaranteed by [the Act], the unit appropriate for purposes of collective bargaining shall be the employer unit, craft unit, plant unit, or subdivision thereof." These broad directives have been held to vest in the Board wide discretion in determining when a unit is appropriate.[30]

Traditionally, the Board, in acting on an election petition, decides whether the petitioned-for employee group shares a sufficient "community of interest" to warrant designating those employees *an* appropriate unit.[31] "Community of interest" is a multi-factor standard taking into account such matters as:

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[29] See, Abodeely, *supra* note 24, at 250-90 and Note, *The National Labor Relations Board's Proposed Rules on Health Care Bargaining Units*, 76 VA. L. REV. 115, 127-44 (1990).

[30] The Supreme Court, in *Hearst Publications v. N.L.R.B.*, wrote:

> Wide variations in the forms of employee self-organization and the complexities of modern industrial organization make difficult the use of inflexible rules as the test of an appropriate unit. Congress was informed of the need for shaping the unit to the particular case and accordingly gave the Board wide discretion in the matter. 332 U.S. 111, 134 (1944).

> (1) similarity in the scale and manner of determining earnings; (2) similarity in employment benefits, hours of work and other terms and conditions of employment; (3) similarity in the kind of work performed; (4) similarity in the qualifications, skills and training of the employees; (5) frequency of contact or interchange among employees; (6) geographic proximity; (7) continuity or integration of production processes; (8) common supervision and determination of labor relations policy; (9) history of collective bargaining; (10) desires of the affected employees; (11) extent of union organization.[32]

Application of the standard is formally based on detailed and intensive factual analysis, but the complexity of the standard itself and the subtlety of some of its components tends to broaden rather than constrain the Board's exercise of discretion. These characteristics of the standard also invite protracted evidentiary presentations and fine legal distinctions. The hearing process and, in turn the decisional product, is often prolix.[33] Nevertheless, over time, the body of decision reflects common approaches to recurring issues that provide a substantial degree of predictability in unit determinations.

In the health care setting, the Board's treatment of two categories of employees--registered nurses and skilled maintenance workers--well illustrates the unit problem. Shortly after the Health Care Amendments became effective, the Board held, in *Mercy Hospitals*,[34] that a unit consisting only of registered nurses (RNs) was appropriate given the RNs' work roles and professional separateness. That decision and similar ones finding separate units for RNs to be appropriate rather than including them in "all professional" units provoked judicial disapproval on the grounds that the Board had adopted a per se rule for RNs, a particularly objectionable approach in light of the "congressional admonition" against unit proliferation. In *NLRB v. St. Francis Hospital of Lynwood*,[35] the Ninth Circuit Court of Appeals concluded:

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[31] Under the Act, the unit need be only *an*, not *the* appropriate unit. Thus, categories of employees may grouped a number of different ways and satisfy the appropriateness requirement. The issue for the Board is normally whether the petitioned-for unit is appropriate.

The immediate consequence of determining a unit to be appropriate is that the employees within that unit will be the constituency in the representation election; the ultimate consequence is that if the union prevails in the election, those employees will constitute a separate unit for purposes of collective bargaining.

[32] N.L.R.B. v. Purnell's Pride, Inc., 609 F.2d 1153 (5th Cir. 1980).

[33] See e.g., Subrin, *supra* note 3, at 105-06:

> In ascertaining the community of interest, the Board for over forty years has looked at such factors as the nature of the work, skills and compensation of the employees, supervision, functional coherence, and geographical separation. Board volumes are replete with decisions containing lengthy narratives as to whether the plant manager can hire or fire or schedule or grant overtime, which parking lot or restrooms various groups use, how many employees transferred into the unit from elsewhere in the plant, or which employees wear common uniforms.

> [That line of] precedent contravenes the congressional admonition by establishing an irrebuttable presumption in favor of certain units. While Congress did not pass S.2292 which would have set up a uniform four-unit for all nonprofit hospitals, that failure does not sanction the Boards's establishment of its own more extensive five-unit standard....[36]

The Board thereafter made explicit that its approach to RN petitions was to apply its traditional "community of interest" standard on a case-by-case basis and asserted that the body of cases, predominantly finding separate RN units appropriate, both was consistent with that standard and reflected sensitivity to the expressed congressional concern with unit proliferation.[37]

Despite the Board's effort to fit health care unit determinations into its community of interest approach, the Ninth Circuit assertion in *St. Francis Hospital of Lynwood* that the "congressional admonition" required a "disparity of interest" approach gained growing judicial acceptance.[38] Under this approach, only a demonstration that the interests of an employee group, such as RNs, was disparate from a larger grouping, such as "all professionals," would justify finding a separate unit appropriate.[39] In response, the Board made still another effort to satisfy the courts that it was acting consistently with congressional intent. Acting on a petition for a separate unit of skilled maintenance workers in *St. Francis Hospital I,*[40] the Board identified seven potentially appropriate units: physicians, registered nurses, other professionals, technical employees, business office clericals, service and maintenance employees, and skilled maintenance employees. Only if a petition sought one of these units would the Board proceed to the "community of interest" analysis. This approach would thus respect the nonproliferation concern by limiting the number of possible units to seven, while at the same time preserving the "community of interest" standard. Before the *St. Francis I* approach had been subjected to judicial review, however, the Board shifted course and, in *St. Francis II*,[41] adopted essentially the "disparity of interest" test of the Ninth Circuit. *St. Francis II* was also short-lived. Joining several other circuits[42] that had not followed the Ninth Circuit's call for a "disparity of interest" test, the D.C. Circuit held in I.B.E.W., Local 474 (St. Francis Hospital)[43] that the "congressional admonition" did not compel a "disparity of interest" approach and remanded the case to the Board. Thus, in early 1987 the Board found itself again searching for an approach to health care bargaining unit determinations that could command substantial judicial support.

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[34] Mercy Hospitals of Sacramento, 217 N.L.R.B. 765 (1975).

[35] 601 F.2d. 401 (9th Cir. 1979).

[36] Id. at 414.

[37] Newton-Wellesley Hospital, 250 N.L.R.B. 409 (1980).

[38] See e.g., Presbyterian/St. Lukes Medical Center v. N.L.R.B., 653 F.2d. 450 (10th Cir. 1981).

[39] It is not the similarity of employee's training, hours, conditions and activities which determine the appropriateness of the unit. It is, rather dissimilarity of interests relevant to the collective bargaining process that determines which employees are not to be included in a proposed unit. The proper approach is to begin with a broad proposed unit and then exclude employees with disparate interests. One should not start with a narrow unit..., and then add professionals with similar interests. Id at 457 n.6.

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[40] 265 N.L.R.B. 1025 (1982).

[41] 271 N.L.R.B. 948 (1984).

[42] Masonic Hall v. NLRB, 699 F.2d 626 (2d Cir. 1983); Watonwan Memorial Hospital v. NLRB, 711 F.2d 848, 850 (8th Cir. 1983); NLRB v. Walker County Medical Center, 722 F.2d 1535, 1539 at fn.4 (11th Cir. 1984).

[43] Electrical Workers IBEW Local 474 (St. Francis Hospital) v. NLRB 814 F.2d 697 (D.C. Cir. 1987).

The Board later described the conflict in the circuits as follows:

## C. Notice of Proposed Rulemaking

The Board's initial response to its dilemma was, on April 8, 1987, to grant review and set for oral argument *St. Vincent Hospital*, a post-*St. Francis II* of a regional director's decision refusing to find appropriate a separate RN unit. Oral argument was heard on May 4 on the lingering question of what test should be used for health care unit determinations and particularly on the question of the significance of the legislative history of the Health Care Amendments of 1974 to that question. While *St. Vincent* was under consideration,[44] the Board decided to abandon its effort to formulate a health

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The Ninth and Tenth Circuits have held that the legislative history requires a ""disparity of interest"s" analysis. See, e.g., NLRB v. HMO International, *supra*; NLRB v. St. Francis Hospital, *supra*; Southwest Community Health Services v. NLRB, 726 F.2d 611, 613 (10th Cir. 1984); Presbyterian/St. Luke's Medical Center v. NLRB, 653 F.2d 450, 457 (10th Cir. 1981). Moreover, those circuits interpret the ""disparity of interest"s" approach as sanctioning narrow units only if the differences in interests between the employees in the unit sought and other employees are so great as virtually to preclude organizing on a broader scale. See, e.g., HMO International, 678 F.2d at 808, 812 fn. 17; Southwest Community Health Services, 726 F.2d at 613. Several other circuits, however, have rejected this rigid ""disparity of interest"s" approach, and have held instead that the Board may use a traditional "community-of-interests" analysis, provided it weighs the public interest in avoiding unit proliferation against the employees' organizational rights. Watonwan Memorial Hospital v. NLRB, 711 F.2d 848, 850 (8th Cir. 1983); Trustees of the Masonic Hall v. NLRB, 699 F.2d 626, 632, 641 (2d Cir. 1983); NLRB v. Walker County Medical Center, 722 F.2d 1535, 1538--1539 (11th Cir. 1984). Other courts, while not expressly rejecting the rigid ""disparity of interest"s" approach, have adopted the view that the Board must take the congressional admonition against unit proliferation into account in making health care unit determinations. NLRB v. Frederick Memorial Hospital, 691 F.2d 191 (4th Cir. 1982); NLRB v. Hillview Health Care Center, 705 F.2d 1461 (7th Cir. 1983); Mary Thompson Hospital v. NLRB, 621 F.2d 858 (7th Cir. 1980); Bay Medical Center v. NLRB, 588 F.2d 1174 (6th Cir. 1978); Allegheny General Hospital v. NLRB, 608 F.2d 965 (3d Cir. 1979); NLRB v. West Suburban Hospital, 570 F.2d 213 (7th Cir. 1978); St. Vincent's Hospital v. NLRB, 567 F.2d 588 (3d Cir. 1977). Most recently, in IBEW Local 474, the D.C. Circuit not only rejected the view that the amendments mandate the use of a ""disparity of interest"s" standard, 814 F.2d at 715, but held that Congress' failure to amend Sec. 9 of the Act (dealing with unit determinations) indicates that Congress implicitly approved the continued use of the "community-of-interests" approach in health care institutions. Id. at 711. The Court did indicate that the Board might, in its discretion, switch to a ""disparity of interest"s" standard if it explained its action adequately. Id. at 711-712 and fn. 65. St. Vincent Hospital and Health Center, 285 N.L.R.B. 365, 366 n. 8 (1987).

[44] See, *infra* notes 47-48 and accompanying text.

deep frustration with the adjudicatory process on this issue was apparent in language of the July 2, 1987 notice of proposed rulemaking (NPR I). After reviewing the litigation history since the 1974 Amendments, the notice observed:

> Thirteen years and many hundreds of cases later, the Board finds that despite its numerous, well-intentioned efforts to carry out congressional intent through formulation of a general conceptual test, it is now no closer to successfully defining appropriate bargaining units in the health care industry than it was in 1974.[45]

Nearly 2 months later, the Board announced its decision on remand in *St. Vincent*. It disposed of the case by continuing to apply its "disparity of interest" test, and it asserted that the D.C. Circuit in *St. Francis II* had simply misunderstood its rationale for this approach. At the same time the Board pointed to the rulemaking it had begun as its intended method for ultimately resolving the policy controversy. The Board also indicated its intention to continue to apply the "disparity of interest" test until the rulemaking was concluded.[46]

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[45] NPR I, *supra* note 6, at 25,143.

[46] The Board explained its decision to continue applying current law as follows:

> In the meantime, petitions will continue to be filed by labor organizations seeking to represent health care employees, and the Board is faced with deciding how to deal with those petitions while the rulemaking proceeding is pending. Three choices appear to be available: to take no action on such petitions until the final rule is issued; to make determinations under some new interim standard; or to continue to decide cases under extant Board law.
>
> We reject the first option---deferring action pending issuance of the final rule--because it would leave the parties in limbo for an undetermined period of time--at least several months. In our view, such a lengthy period of inaction certainly would not "assure to employees the fullest freedom in exercising the rights guaranteed by the Act," and in fact would deprive them of those rights until the final rule was issued. In addition, since we have determined that the final rule will be prospective in application only, inaction pending the outcome of the rulemaking proceeding would merely result in delay, and in any event would not result in the final rule being applied to pending cases such as this.
>
> We also choose not to process cases under any new interim standard, in part because any such standard necessarily would be of brief duration, ending shortly after the final rule was promulgated. Moreover, the oral argument persuades us that it would be advisable to obtain empirical evidence before devising a new standard. Lastly, an interim standard would add unnecessarily to the adjustments petitioners and employers must make as the Board moves from case-by-case adjudication to rulemaking.

# V. The Rulemaking

## A. Planning for Rulemaking

In its incipient stage, the health care unit rulemaking presented novel questions for the Board that would have been routine in agencies which regularly used notice-and-comment rulemaking. Most of these questions concerned rulemaking procedure or the Board's authority to engage in rulemaking for unit determinations. Other questions more fundamentally reflected the uniqueness of this undertaking for the Board. Some of those warrant attention before turning to the questions of authority and procedure.

The decision to proceed by rulemaking was made at a Board meeting on May 15, 1987, 10 days after the oral argument in *St. Vincent*. Members Babson, Stephens and Cracraft voted in favor of proceeding by rulemaking; Chairman Dotson and Member Johansen voted against. Thus, even at the point the Board committed itself to rulemaking, there was sharp division as to the desirability of proceeding in this fashion. The transcript of this open meeting provides an interesting perspective on just how fundamental the decision was given traditional Board practice and procedure. The exchanges from the transcript, set out below at some length, are part of a unique informal record of the views of Board members at a critical juncture in Board history.

## B. The Rationale for Rulemaking

Some of explanation offered by the Board members for their positions reflected fundamental disagreement about the purpose and possible value of rulemaking:

Chairman Dotson: "What would we expect to learn in this process that we don't already know through the litigation, oral arguments that have taken place?"

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> Therefore, we have decided to continue to process cases under existing law until the final rule has been issued. That is, we will continue to make bargaining unit determinations in the health care industry using the ""disparity of interest"s" analysis announced in St. Francis II, and which we have applied in subsequent cases.

St. Vincent Hospital, *supra* note 43, at 366.

Member Babson: "That's like asking what is it that we don't know. It's hard to say."

Chairman Dotson: "Well, I'm wondering what conceivably could there be that would come forward in this process that would not have come forward in these other procedures? What kind of information?"

Member Babson: "I don't know that any of us can answer that question, Don, but as I understand the process, it provides the opportunity for any interested party, anybody arguably affected by the rule to come forward to provide us with information, some of which we may have already seen in the context of our case-by-case adjudication. Some of it we may not have seen but essentially, providing an unimpeded opportunity for all affected parties to come forward so that we can have a general approach.... We will certainly find out by giving people the chance to say anything they want to say and one of the salutary advantages of rulemaking is not only to gain the experience but to enable us to apply a rule and avoid days and days of repetitious hearing on the same issues year after year.... It is impossible for us to state here and now, what is it we do not know until we give people the opportunity to tell us."

Member Stephens: "Well, it seems to me that the thrust of the brief of the American Hospital Association [in St. Vincent's] was that there has been this dynamic revolution in the hospital industry since 1974 so that things are much more highly integrated among the professions than ever before. And it seems to me that underneath that argument is the point that now more than ever there may be an increased risk of proliferation even with just more than a couple of units. And if things are so highly integrated now that there really is a bar to community of interest that necessarily supports... no more than two units. I don't think we could take cognizance of that argument in an adjudication because that's not evidence that's in the record. Not in the St. Vincent's record which was presented to the Regional Office and then presented to us. If that is a valid point, that we should take into account in fact in the rule, that they should be given the opportunity to submit that to us formally, I think, in a rulemaking proceeding, in the hearing, and if other parties want to respond to that they should be given the chance to talk about what the current state of affairs in the healthcare industry is."

* * *

Chairman Dotson: "In that context, those things tend to be more assertions whereas in the adjudicatory process it takes the form of record evidence. I feel more comfortable with record evidence and if these changes occur they will be reflected in the cases we receive later.[47]"

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[47] Transcript of Meeting of May 15, 1987, pp. 20-22.

That disagreement became even more contentious when the discussion turned to the question of including a specific proposal in the notice of proposed rulemaking rather than indicating only an intent to make a rule on the subject of health care units:

Member Babson: "I would propose that the initial promulgation be a proposed rule that specifies proposed units in various sizes and kinds of healthcare institutions versus or as opposed to simply soliciting comments *ab initio* without any suggested delineation of units."

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Member Johansen: "My only comment again would be I would think that if we are going to recommend what appropriate units are, and we're going to say we're doing this because relying upon our expertise and knowledge we have gained, that we just list...the units we have been going by.... That gives some credence to the statement that all these 13 years we have gained all this knowledge and this is knowledge and this is what we think is appropriate.

* * *

Mr. Subrin (Director of the Office of Representation Appeals): "I think you would be much better off to deviate a little bit from what you have done in the past, otherwise the unions are going to come rushing in and they are going to see this as your way of codifying and putting in granite the units they have fought tooth and nail against.

* * *

And by deviating a little bit, then if you ultimately decide to scratch ... [a] unit ... because it would be proliferative...that would also make more credible that you listened to what was said in the hearing."

Chairman Dotson: "That strikes me as a little cynical. I'm having trouble understanding how we're going to hear anything a whole lot different from what we've heard in the oral argument and whatwe've heard in many briefs about this.

Member Stephens: "I don't see anything cynical about this. I disagree and I think Marshall's point is well taken that we don't know what we're going to receive in the way of information here."

Chairman Dotson: "Isn't it a fact that we appear to have a majority now in favor of giving the registered nurses a separate unit? And that this is a convoluted way to go about it?"

Member Stephens: "No, I don't think that's the case at all. Some people might perceive it that way, that might be your view, but that's not my view."

Member Babson: "It's not my view either. That's a cynical view. What we're doing is that we're providing a basis for discussion and for those who are concerned about prejudgment, to simply come up with a draft that doesn't engender a lot of discussion, the fact of the matter is even if we were to start with a more general approach, at some point in time we have to draft a proposal and at any time we put out a draft with some specifics in it, I suppose we're a candidate for being accused of prejudging...."

Chairman Dotson: "I'm struck by the fact that in the oral arguments the representatives of both the employers and the unions showed no enthusiasm for going into rulemaking at this point and were much more concerned about the Board getting on with the decision-making process and getting cases decided. And that's what I'm concerned about. I agree with them about that. And I have not been able to see how changing the format of the decision changes the ultimate decision or is going to change what is laid before us. The principal difference I can see here is delay and confusion."

Member Stephens: "Well, I don't see that. I don't see how it's going to be any more confusing or more delay-prone than the current state of affairs."

* * *

Member Cracraft: "In terms of what would occur in the interim and possible confusion due to promulgation of the proposed rule, what would we anticipate....

Member Stephens: "In terms of adjudication?"

Member Cracraft: "Yes, in terms of how to handle interim cases."

Member Babson: "Can we avoid talking about that?"

Member Cracraft: "No, I'm not asking substantively, I'm just asking would we continue to adjudicate all cases arising in the interim?"

* * *

Member Babson: "Well, if we did it the way Jim [Stephens] suggested then it should be clear to everyone that during the interim period that we will continue to adjudicate cases on a case-by-case basis according to whatever disposition we make in the *St. Vincent* case. In other words, we should make abundantly clear and we can even refer to the rulemaking in the decided cases. But I think you are correct to have concern about the impact... And if parties choose to wait until the rulemaking process is completed, that's their business. But if they choose to continue to file petitions or to oppose organizing on any basis, if the petition is filed, I think they clearly have the right to do it and we have an obligation to process those cases."

Member Cracraft: "I think we will see people citing the proposed rule saying this unit is appropriate because it conforms to the proposed rule."

Member Stephens: "Well, we'll know what weight to give that... We're making the decision."

* * *

Member Babson: "If we do what we say we're going to do, then we shouldn't have any problem because as Jim says, we're the ones who are going to decide the cases."

Chairman Dotson: "As I understand it, you don't really know what you want to do about these units and you believe that rulemaking will allow you to better decide what you want to do with these units."

Member Stephens: "That's a loaded question. If you're going to accuse us of not knowing what we're doing, I think it's fair to say that this is a useful starting place."

Chairman Dotson: "I didn't say that you didn't know what you were doing. I said, do I understand correctly that you are undecided as to what to do?"

Member Stephens: "Well, that's a different question and I think that it's fair to say that we are ultimately undecided. This is a useful starting point."

Chairman Dotson: "And you believe that the rulemaking procedure will somehow provide you with something we don't already have from the Congressional hearings and the previous litigation and the oral arguments and the many briefs that have been filed."

Member Stephens: "That's right. And, as I pointed out, it would provide a basis for taking cognizance of things that were presented during oral argument which we technically, I don't think, could take cognizance of in deciding the *St. Vincent's* case. And, hopefully, I think the leap of faith that we are making here is that this will facilitate the administration of the Act. And, the fact that we cannot empirically demonstrate that, I don't think should deter us...."

* * *

Member Babson: "...I would suggest that we close the meeting at this point to talk about the disposition of *St. Vincent's*, the disposition of which hopefully will provide the basis on which a case-by-case adjudication of other cases may be decided during the rulemaking process."[48]

While the transcript cannot be expected to reflect completely the factors which underlay the judgment of individual Board members to support or oppose rulemaking, the discussion reveals at least some attention to a number issues that have surrounded calls for greater Board use of rulemaking: (1) whether rulemaking would stimulate the submission of useful empirical data or would simply attract the same generalized legal/policy arguments heard in adjudications, (2) whether the data that might be submitted would provide as reliable a basis for policymaking as the evidence that is admitted and tested through cross-examination in adjudications, (3) whether loss of the assumed sensitivity of case-by-case would be offset by the assumed speed and efficiency of a generalized approach, (4) whether the process of proposing and possibly modifying proposed rules calls into question or enhances the concept of Board expertise, (5) whether the Board's regulated constituencies would find rulemaking credible and participate, and (6) whether the Board would be able to continue to adjust policy through adjudication having undertaken rulemaking.

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[48] Id. at 24-40.

The Board discussion in this meeting, as well as in one further public meeting,[49] translated into a two-part rationale for proceeding with rulemaking set out in NPR I. First, after reviewing briefly the unstable and litigious background of health care unit determinations, NPR I suggested that there would be value in obtaining from a range of affected parties empirical data on the effect of unit configuration on labor relations in the health care industry.[50] Second, it asserted that the Board's 13-year experience with health care units reflects much commonality among health care facilities that leads to "predictable groupings" of employees and that provides the basis for proposing a specific rule for consideration.[51]

The NPR also noted the longstanding criticism the Board had received from commentators for its reluctance to use rulemaking for a policymaking vehicle.[52] The rationale concluded with the Board's "opinion that rulemaking, though perhaps time consuming at the outset, will be a valuable long-term investment, paying dividends in the form of predictability, efficiency, and more enlightened determinations as to viable appropriate units."[53]

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[49] Meeting of June 9, 1987.

[50] The NPR read:

> It is clear to us that the key element in the Board's avoidance of proliferation is to designate how many units will be deemed appropriate in a particular type of health care facility. In so doing, the Board must effectuate section 7 rights by permitting bargaining in cohesive units, units with interests both shared within the group and disparate from those possessed by others; weighed against this must be Congress' expressed desire to avoid proliferation in order to avoid disruption in patient care, unwarranted unit fragmentation leading to jurisdictional disputes and work stoppages, and increased costs due to whipsaw strikes and wage leapfrogging. Though the Board has of times made broad generalizations as to which types of unit configurations would or would not lead to proliferation and the catalogue of undesired results, it cannot be denied that it has never obtained empirical data on these matters. This, along with the still unsettled state of the Board's past, doctrinal efforts after so many years, is one of the major reasons for the Board's deciding to engage in rulemaking.

NPR I, *supra* note 6, at 25,143.

[51] The NPR read:

> Another major reason is a reflection of the Board's extensive experience. The Board has in the last 13 years received many hundreds of petitions for health care units. Generally, the units requested have been in approximately six, predictable groupings: registered nurses, other professional employees, technical employees, business office clerical employees, service and maintenance employees, and skilled maintenance employees. Only occasionally have units of guards or physicians been sought. It is our observation that these groups of employees generally exhibit the same internal characteristics, and relationship to other groups of employees, in one health care facility as do like groups of employees at other facilities. To put the matter another way, the various health care facilities we have examined over the years have looked very much the same as other facilities of the same type: large acute care hospitals, small acute care hospitals, and nursing homes.

NPR I, *supra* note 6, at 25,143-44.

## C. Authority for Rulemaking

Section 6 of the National Labor Relations Act expressly grants the Board rulemaking authority:

> The Board shall have authority from time to time to make, amend, and rescind, in the manner prescribed by the Administrative Procedure Act, such rules and regulations as may be necessary to carry out the provisions of this Act.[54]

Thus, the general authority of the Board to engage in rulemaking was not in doubt. The section 9(b) directive to the Board to determine appropriate units, however, provides in part:

> The Board shall decide *in each case* whether...the unit appropriate for the purposes of collective bargaining shall be the employer unit, craft unit, plant unit, or subdivision thereof...(emphasis added)[55]

Anticipating arguments that the "in each case" language precluded the use of rulemaking for unit questions, NPR I set out the basis for the Board's contrary view. It quoted in full Professor Kenneth Culp Davis' emphatic conclusion that the language could not have been intended to have such effect:

> Do the words "in each case" mean that the Board is prohibited from classifying problems, from developing rules

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[52] The Board cited most of the critical commentary in the literature, see *supra* note 3, and quoted one of the bluntest expressions of criticism:

> Rather than providing a basis for decisions that only a supposedly expert agency could make--by evaluating the available empirical, economic literature an systematically distilling the accumulated experience of Board personnel and of the labor relations community generally--the Board acts as a kind of Article I "Talmudist" court, parsing precedent, divining the true meaning of some Supreme Court ruling, and balancing in some mysterious fashion competing, yet absolute-sounding values.

Estreicher, *supra* note 3, at 172.

[53] NPR I, *supra* note 6, at 25,144.

[54] 29 U.S.C. §156.

[55] 29 U.S.C. §159(b).

> or principles, or from relying on precedent cases which establish narrow or broad propositions? The answer has to be clearly no; the Board may decide "in each case" with the help of such classifications, rules, principles, and precedents as it finds useful. The mandate to decide "in each case" does not prevent the Board from supplanting the original discretionary chaos with some degree of order, and the principal instruments for regularizing the system of deciding "in each case" are classifications, rules, principles, and precedents. Sensible men could not refuse to use such instruments and a sensible Congress would not expect them to.[56]

The Notice then referred to both judicial and scholarly observations that the unit determination process, in particular, could benefit from rulemaking by providing a vehicle for obtaining and evaluating empirical data concerning how various unit configurations affect bargaining.[57] Finally, it suggested the sort of empirical questions participants in the rulemaking process might address.[58]

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[56] NPR I, *supra* note 6, at 25,144, citing Davis, Administrative Law Text 145 (3d ed. 1972).

It is interesting to note that scholarly commentary encouraging the Board to make greater use of its rulemaking authority, including the view of Professor Davis, was the subject of discussion in the open meeting at which the content of NPR I was discussed:

> Mr. Babson: "I don't think for example, that the document should suggest that the only reason why we are engaging in rulemaking, is because all these distinguished commentators think that we should.
>
> I think that the Board in its judgment, in its collective wisdom, I think that we are aware of this commentary.
>
> Much of it is well taken. But, really, the impetus for the decision is that there is, I think, a view that it will benefit the agency; that the time has come to try to avoid some of the relitigation that we have experienced.
>
> * * *
>
> That is not to say that [the commentary] needn't be referred to. I think that we can probably refer to it, but, I don't think that the reason that we are doing it is because we were all in law school at some time when Kenneth Davis was criticizing the NLRB for not engaging in rulemaking."

Transcript of Meeting of June 9, 1987, pp. 10-11.

[57] Id. at 25145

[58] Id. The Board described its interest as follows:

Ultimately, the "in each case" language became the basis for one of the three major legal arguments made in challenge to the final rule.[59] The initial notice of proposed rulemaking addressed this potential issue only in the limited fashion described above. This may have been the product of a view that issue was not a particularly significant one or that the notice of proposed rulemaking was not the proper vehicle for setting out fully an agency's position on a legal question.

## D. Procedure for the Rulemaking

While the notice-and-comment procedures of section 553 of the APA would have required only an opportunity for written comments on the proposed rule, the Board decided for a variety of reasons to hold public hearings, to receive oral and written comments, and to permit limited cross-examination.[60] First, and perhaps most important, was the desire to assure affected parties that there would be the fullest opportunity to participate as the Board undertook a new method of policy formulation. Second, there was some concern that without oral testimony and cross-examination, the Board would receive through written submissions only legal arguments of the kind it traditionally heard in adjudications. Third, the notion of a contested proceeding with one group of participants testing the positions of the opposing

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> The Board wants to learn how various bargaining units affect legitimate concerns of both unions and health care employers. For example, when registered nurses have been grouped with other professionals, have their interests been properly represented? Has the bargaining, when it has occurred in all-professional groups, nonetheless proceeded on the basis of each separate profession? Have wage rates been negotiated separately despite the all-professional units? When they have existed, have separate professional groupings resulted in interruption in the delivery of health care? Wage whipsawing? Jurisdictional disputes? These are merely examples of the types of questions that should be addressed by anyone testifying for or against separate units, such as registered nurses, business office clericals, technicals, maintenance employees, etc. The Board is not seeking at the oral hearings the "opinions" and further legal arguments of counsel, which may be submitted as comments, but, rather, actual, empirical, practical evidence offered by industry and union representatives who have themselves participated in or observed bargaining in the health care industry in various configurations. The Board also desires evidence from witnesses with direct knowledge about any recent changes in the delivery of health care, such as cost containment, allegedly greater integration of function between categories of health care employees, and changes in function of specific classifications of health care employees, including greater or lesser degrees of specialization, that may have an impact on the question of appropriate units.

Id.

[59] See, e.g., Brief for Petitioner at 13-25, *American Hospital Association v. NLRB*, United States Supreme Court (No. 90-97).

[60] Interviews, *supra* note 8.

participants through a form of dialogue would be consistent with the model of labor-management relations the Board and its constituencies generally accepted. Finally, there was a view that in this novel undertaking the Board should minimize the likelihood of legal challenge to the action on procedural grounds.

Hearings were scheduled and held at three locations: Washington, DC on August 17 and 18, 1987, Chicago on August 31 and September 1, 1987, and San Francisco on September 14, 15, and 16, 1987. The objective again was to permit the widest practicable participation through geographical dispersion of the hearing venues. A fourth hearing was later scheduled and held in Washington, DC on October 7, 8, 9, 13, 14, 15, and 16, 1987. The initial comment period was scheduled to end October 30, 1987 (120 days after the initial notice), but was extended three times.[61]

The procedure for the hearings was described in NPR I as follows:

> Persons wishing to present oral testimony at any one of the specified locations should notify the Office of the Executive Secretary...no later than July 24, 1987, advising it of the location at which the witness wishes to testify. Thereafter, all witnesses should submit to the Executive Secretary...eight copies of either the written text or a summary of their presentations no later than 1 week prior to the commencement of the hearing at which they wish to testify. Copies of these texts and summaries will be placed in the docket and will be available at the Executive Secretary's Office, and also at the hearing location where the witness intends to testify, for examination by interested persons.
>
> An administrative law judge will preside over the hearings, which will be informal, legislative-type proceedings at which there are no formal pleadings or adverse parties. In general, oral presentations from individual witnesses will be limited to 20 minutes each, except that the presiding judge may impose a greater or lesser period, at the judge's discretion, if he or she deems it appropriate. Participants may desire to ask questions on crucial issues following a presentation. Such questions may be permitted by the judge, limited to approximately 15 minutes per questioner. Questions must be

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[61] NPR I, *supra* note 6, at 25,142; Collective Bargaining Units in the Health Care Industry, 53 Fed. Reg. 33,900 (Second Notice of Proposed Rulemaking, September 1, 1988) [hereinafter NPR II].

> designed to clarify a presentation and/or elicit information that is within the competence or expertise of the witness; questions that are argumentative or in the nature of a statement will not be permitted. The judge shall have discretion to modify the time for questioning, and shall have further discretion to impose other guidelines for the orderly and efficient conduct of the hearing. This shall include the right to require a single representative to present the views of two or more persons or groups who have the same or similar interests, and to identify such persons or groups with similar interests.
>
> The Board will be represented at the hearings by a member of its staff. The judge and the Board representative shall have the right to question persons making an oral presentation as to their testimony and any other relevant matter.
>
> A verbatim transcript of the hearings, and the written statements and comments, will be available for public inspection during normal working hours at the Office of the Executive Secretary.[62]

The Board assigned a senior Administrative Law Judge[63] to the hearings who, in consultation with the participants and in light of developments at the hearings, refined these procedures.

At the first Washington hearing 20 witnesses appeared, and 496 pages of testimony were taken. At the Chicago hearing 27 witnesses appeared, and 521 pages of testimony were taken. At the San Francisco hearing 39 witnesses appeared, and 762 pages of testimony were taken. Finally, at the second Washington hearing 58 witnesses appeared, and 1766 pages of testimony were taken.[64] The witnesses included employees in most of the job classifications at issue in the proceedings, national and local union officials representing these employee groups, health care employers in various categories, representatives of health care trade associations and professional organizations, and individual health care professionals and academics.[65]

Accommodating large numbers of witnesses and participants interested in cross-examining witnesses, posed various problems for the presiding judge.

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[62] NPR I, *supra* note 6, at 25,148.

[63] The Administrative Law Judge for the hearings was Bernard Ries.

[64] NPR II, *supra* note 61, at 33,900.

[65] Id.

The published procedure--requiring written statements in advance, limiting time for presentation and cross-examination, and grouping representatives with common interests--proved somewhat difficult to implement. It was clear the Board intended the judge only to perform a traffic control function and that it wanted participants to have as much flexibility in making their presentations as reasonably possible. Thus, in organizing the hearings and ruling on time requests and opportunities for questioning, the judge's approach was generous. While multiple hearings at multiple locations enhanced the opportunity for participation, it also created certain scheduling and traveling problems, especially for participants who felt it necessary to participate at each location. Finally, while the opportunity for questioning (cross-examination) gave the hearings and ultimately the record a richer character, it necessarily extended the time necessary for the hearings, and given the tolerant standard being applied, some of the questioning like some of the underlying presentations only contributed marginally to the value of the record.

It is clear that the choice of oral hearings provided the opportunity for broad participation. Unions, particularly those which had the most at stake,[66] participated more actively and more thoroughly in the proceedings than did health care management representatives. Some of these unions presented testimony that included empirical data on effect of unit configuration on health care labor relations generally, and strike activity in particular. The industry testimony was not as empirically oriented and relied heavily on general policy arguments and the legal issues related to the "congressional admonition." While the Board had some initial concern in undertaking the rulemaking that either side might choose not to participate substantially,[67] it is not entirely clear why management participation was relatively limited.

A number of explanations are possible. Any rule establishing standard health care units would to some extent constrain litigation opportunities for management in resisting unionization and, in turn, likely speed the certification process. Moreover, the particular units proposed in NPR I were simply more numerous than those that hospitals had sometimes been able to achieve through litigation. It is thus possible that some health care industry components assumed, given the division in the Board on the question of whether even to proceed to rulemaking, that the more limited the participation, the less likely the Board would ever issue a final rule. Similarly, if the industry assumed that the Board was firmly committed to the units set out in the initial proposal, some may have reasoned that active management participation would only lend credibility to a proceeding that would not lead to a favorable result from the industry perspective. Some unions may have assumed that the initial proposal was a deceptive opening gambit in a proceeding intended to lock in through a rule the more restrictive unit position the Board had taken in recent years, and therefore that their active participation was essential as a defensive matter. Both sides may also have perceived the initiation of the proceeding as something of an "olive branch" to unions that had come to believe that the Board was increasingly hostile to their interests. How this might have affected participation is uncertain. It is clear, however, that the very uniqueness of the proceeding for the Board undoubtedly encouraged speculation on both sides as to the significance of the undertaking, and thus, may have affected the vigor of participation.

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[66] Among the most active participants were unions representing registered nurses and skilled maintenance workers.

[67] Interviews, *supra* note 8. Some Board members had informal conversations with union and management representatives to determine whether the parties would participate actively in a rulemaking if one were undertaken.

## E. The Terms of the Proposed Rule

The rule proposed in NPR I covered only acute care hospitals and nursing homes, thus excluding such facilities as psychiatric hospitals for which unit determinations would continue to be made on a case-by-case basis. It provided in pertinent part:

> With respect to employees of "health care institutions" as defined in section 2(14) of the Act, no petition for initial organization shall be entertained, except under extraordinary circumstances, if the petition seeks certification in a bargaining unit not in substantial accordance with the provisions of this rule. The following shall be the only appropriate units, except that any combination will also be appropriate, as the union's option and so long as the requirements of section 9(b) (1) and (3) [governing professionals and guards] are met:
>
> (1) Appropriate units in large, acute care hospitals, which shall be defined as all acute care hospitals having more than 100 patient beds:
>
> (i) All registered nurses.
>
> (ii) All professionals except for registered nurses and physicians.

> (iii) All physicians.
>
> (iv) All technical employees.
>
> (v) All service, maintenance and clerical employees except for guards.
>
> (vi) All guards.
>
> (2) Appropriate units in small, acute care hospitals, which shall be defined as all acute care hospitals having 100 patient beds or fewer, [and in all nursing homes]:
>
> (i) All professional employees.
>
> (ii) All technical employees.
>
> (iii) All service, maintenance and clerical employees except for guards.
>
> (iv) All guards.

The proposed rule thus distinguished between large and small hospitals by providing for six units in the former and only four in the latter.[68] The notice asserted that these units reflect the groupings of employees across a broad range of health care facilities that would essentially be "predictable" from the body of Board adjudications since the health care amendments and thus reflect the Board expertise developed over a period of 13 years.[69] The notice went on to give a brief explanation for each unit. Finally, the notice indicated that the

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[68] NPR I, *supra* note 6, at 25,146. The Board explained:

> The Board has tentatively decided, based on its experience, that larger hospitals, with their larger numbers of employees in each category, may warrant one or two additional units. In smaller facilities, it is likely that employees will have more contacts with one another, may to some extent perform one another's work, and generally may share interests more than groupings in larger hospitals. A slightly lesser degree of specialization seems also probable. Recognizing that perfection is impossible in this area, but also being intent on not litigating the precise boundaries of the "small hospital" in each case, the Board has tentatively determined that acute care hospitals of more than 100 patient beds will be deemed "large"; acute care hospitals of 100 patient beds or fewer will be deemed "small." Id.

[69] NPR I, *supra* note 6, at 25,144. See also, Appendix B, "Results of Case-by-Case Adjudications," (Board submission at September 14, 1987 hearing).

"extraordinary circumstances" exception would be applied restrictively to accomplish the litigation-reducing purpose of the rule.[70]

## F. The Product of the Initial Comment Period and NPR II

During the four hearings 144 witnesses testified, producing a transcript of 3,545 pages.[71] In addition, the Board received 315 written comments totalling approximately 1,500 pages. The Board indicated in NPR II that it was "gratified" at the interest shown in the proceeding and that it was "now far better qualified to resolve the issues raised...." NPR II, consisting of more than 35,000 words, covering 36 pages in the Federal Register, reviewed comprehensively the rulemaking record. Apart from addressing the substantive issues related to health care unit determinations, NPR II also treated at some length the question of the desirability proceeding by rulemaking. The notice emphasized the relatively uniform Board approach to health care units in adjudications and the considerable similarity among health care institutions.[72]

Most importantly, it made a number of changes in the initially proposed rule and provided detailed explanation, based in the rulemaking record, for each change and for each component of the revised rule. The notice also provided for an additional comment period "[b]ecause this is the Board's first major effort at substantive rulemaking, and because the Board is desirous of giving all interested parties a further opportunity to comment on the proposed rules, including the substantial revisions."[73]

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[70] NPR I, *supra* note 6, at 25,145. The Board stated:

> Though an "extraordinary circumstances" exception has been included, it is anticipated that the exception will be little used and limited to truly extraordinary situations; the exception is to be construed narrowly and is not intended to provide an opportunity (or loophole) for redundant litigation. Id.

[71] NPR II, *supra* note 61, at 33,900.

[72] NPR II, *supra* note 61, at 33,903. The Board observed:

> Our adjudicatory decisions as to appropriate units in the health care industry, where the facts of each case were painstakingly examined in numerous lengthy and costly representation case proceedings, have been remarkably uniform in results, varying only when the Board changed doctrinal formulations, e.g., from "community" to "disparity" of interests. (NLRB Exh. 5, revised.) Thus, for example, from 1975 to 1984, despite lengthy adjudicatory proceedings the Board found RN units appropriate in 24 out of 25 published cases; technical units appropriate in 18 out of 18 cases; business office clerical units appropriate in 8 out of 8 cases; etc. Though adjudication led to varying results for skilled maintenance units, that was largely a function of a single Board member, Member Jenkins, reaching different results on different records. Other members were, individually, remarkably uniform, despite alleged differences in the records. E.g., Member and Chairman Fanning found the separate maintenance unit appropriate 29 out of 29 times; Chairman Murphy, 26 out of 26 times. Continuing to determine appropriate units in this way seems unproductive, especially considering the lack of universal judicial approval of any single doctrinal approach. Id.

The revised proposed rule eliminated the large-small hospital distinction, observing that "[t]he vast majority of representatives of both unions and employers appeared to agree that hospital size is not well correlated with integration or division of labor, and opposed a rule differentiating between large and small hospitals."[74] The revision also limited coverage of the rule to acute care hospitals, thus excluding nursing homes because "there are not only substantial differences between nursing homes and hospitals but also significant differences between the various types of nursing homes which affect staffing patterns and duties."[75] Most importantly, having eliminated the special provision for smaller hospitals, the revision increased the number of appropriate units from six to eight for all hospitals, carving out a separate unit for "skilled maintenance employees" and for "business office clericals," leaving a possible residual unit of "all non-professional employees." The changes were explained on the basis of the empirical evidence adduced during the initial comment period considered in light of a range of factors traditionally considered in unit analysis and in light of the congressional admonition concerning proliferation of units.[76]

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[73] NPR II, *supra* note 61, at 33,901, citing Note, The Need for an Additional Notice and Comment Period When Final Rules Differ Substantially from Interim Rules, 1981 DUKE L.J. 377 (1981).

[74] NPR II, *supra* note 61, at 33,927.

[75] NPR II, *supra* note 61, at 33,927-29.

[76] NPR II, *supra* note 61, at 33,904-06. The Board observed:

> Although under rulemaking we shall attempt to avoid the doctrinal formulations utilized under adjudication, many of the factors we consider will be similar. Thus, among the factors to be considered will be uniqueness of function; training, education and licensing; wages, hours and working conditions; supervision; employee interaction; and factors relating to collective bargaining, such as bargaining history, matters of special concern, etc. Location and scope of the job market may be relevant: i.e., whether the classification is part of a job market external to the facility or even to health care, or rather shares a job market with others in the facility or, perhaps, in the areawide health care community; job market is a factor not extensively considered under adjudication, probably because evidence regarding it is not likely to be introduced during the litigation of a particular case. In addition to these factors, should the evidence reveal the possibility of a separate unit, we shall examine the likelihood that such a separate unit would result in interruption in the delivery of health care, wage whipsawing, or jurisdictional disputes, matters with which Congress expressed concern during the deliberations that preceded the 1974 amendment. The emphasis, during our rulemaking deliberations, has been and will be on the empirical–what, according to the mass of evidence presented, is warranted and will facilitate collective bargaining without jeopardizing the public interest–as opposed to prior, more doctrinal, more conceptually oriented, determinations. We are confident we are now a better informed administrative body in exercising the substantial discretion which we possess in the area of unit determinations. Id at 33905-06. (Citations omitted).

*TABLE*

**Board Composition During Rulemaking**

| **Member Name** | **Began Service** | **NPR I (7-2-87)** | **NPR II (9-1-88)** | **Final Rule (4-21-89)** | **Ended Service** |
|---|---|---|---|---|---|
| Dotson | (3-7-83) | X | | | 12-16-87 |
| Johansen | (5-28-85) | X | X | X | 6-15-89 |
| Babson | (7-1-85) | X | n1 | | 7-31-88 |
| Stephens | (11-1-85) | X | X | X | Continues |
| Cracraft | (11-14-86) | X | X | X | Continues |
| Higgins | (8-29-88) | | n2 | X | 11-22-89 |
| Devaney | 11-22-88) | | | X | Continues |

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n1 Participated in vote to issue NPR II (7-1-88).

n2 Did not participate in vote to issue NPR II (7-1-88).

Thus, at this crucial juncture in the proceeding, the Board was about to have its membership reduced to three, only two of whom supported the rulemaking. Babson's participation in the vote to continue the proceeding created a 3-1 majority for going forward while not committing the Board to a final rule that might have been supported by only a 2-1 majority at the point at which it would have been published. Whether this was actually a factor in the Board's decision to provide an additional comment period is not as important as the fact the changes in the composition of the Board not only posed the usual prospect for substantive policy shifts but also, in the instance of the first rulemaking, threatened to undermine the procedural choice itself.[78]

## G. The Final Rule

The notice of adoption of a final rule was published on April 21, 1989. It indicated that the Board had received approximately 1,500 comments during the additional comment period; roughly 30 supported the proposed rule in whole or part, while roughly 1,465 opposed it. It also indicated that approximately one-half of the 1,465 comments in opposition to the rule were form letters, "for the most part containing brief arguments without supporting detail."[79] The notice explained that, for the most part, the additional comments "mirror[ed] those made during earlier points in the rulemaking..." and listed nineteen categories into which the arguments fell.[80] From this grouping the Board indicated which it believed it had dealt with thoroughly in NPR I and II and which were dealt with separately in the final notice. With

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[78] In the Final Rule notice the Board indicated that an argument had been made in the second comment period that it should not promulgate a final rule without a full complement of Board members. The notice went on to explain that the issue was now moot inasmuch as there was a full complement. Final Rule, *supra* note 7, at 16,337.

[79] Final Rule, *supra* note 7, at 16,336. The Board elaborated:

> The most common form letter, submitted by over 600 correspondents, briefly exhorts the Board to return to the case-by-case approach and to find appropriate only two units, all professionals and all nonprofessionals, plus the statutorily-mandated separate unit of guards. Otherwise, say these commenters, their ability to provide comprehensive, coordinated care would be adversely affected. * * * The form letter contains blank spaces for such information as "(name of organization)"; "(number)" of health care facilities owned by the commenter; and "(number)" of employees; one submitted copy of the form letter did not have the blanks filled in. Id.

[80] Final Rule, *supra* note 7, at 16,336-37. The categories were as follows:

> a. The health care industry is unfairly being singled out for rulemaking.
>
> b. Rulemaking is contrary to the language of section 9(b), requiring a case-by-case approach.
>
> c. The Board should follow the case-by-case approach of St. Francis II.

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d. The number of proposed units conflicts with the Congressional admonition against proliferation.

e. If the Board establishes units, there should be only two units, professional and nonprofessional, plus guards.

f. The proposal will lead to increased organizing by unions.

g. Multiple units will result in strikes, repeated strike notices, jurisdictional disputes, and other disruptions of health care.

h. Health care costs will substantially increase as a result of strikes, whipsawing, work rules, bargaining, and contract administration.

i. Hospitals will lose needed flexibility.

j. The Board did not consider the changes in the industry such as teams, and the differences between institutions and between employees.

k. The particular units proposed, such as RN and skilled maintenance, are inappropriate.

l. The implementation of the proposed rule will lead to increased litigation.

m. At least 75 commenters argue that the Board should not treat small, rural hospitals as it does other acute care hospitals because they have less money and staff flexibility, and more overlapping employee duties. Moreover, disruptions at these facilities would have a severe impact on providing health care and employment for persons living in their areas since there are few or no other medical facilities nearby. Many of the 75 commenters provide no further detail on this point.

n. Several commenters embrace the arguments made by Member Johansen in his dissent from the Board's decision to continue with rulemaking.

o. Some commenters argue that the Board is inappropriately foreclosing discussion on bargaining unit issues by refusing to hear evidence on issues considered during rulemaking.

p. About 25 commenters argue that no rule should be made with less than a full five-member Board.

q. Some commenters suggest that the Board consider alternative to a rule, such as a Board panel deciding health care cases.

r. A few commenters argue that the implementation of the Board's proposed rule will expedite the Board's election process resulting, in insufficient time for an employer to respond to a union's organizing campaign.

s. Some comments criticize the extraordinary circumstances provision as being too narrow. Id.

one exception, the arguments addressed at length in the final notice related to the substance of the rule.

The exception was a section entitled, "Rulemaking," in which the Board addressed for the first time at length the argument that the "in each case" language of section 9(b) of the Act precludes the use of rulemaking for unit determinations. The section referred to the legislative history of the provision, as well as the previously noted commentary arguing against this construction of the statute. It also noted that adjudicative decisions of the Board in unit cases in effect create "rules" of general applicability to determine appropriate units.[81] Moreover, for the first time in the rulemaking, the Board referred to *Heckler v. Campbell*,[82] a Supreme Court decision upholding the authority of the Secretary of Health and Human Services to use rules to limit the issues that require case-by-case consideration under a statutory scheme that, like 9(b) of the NLRA, required a individual determinations.[83] Finally, it expressed confidence in the value of the product of the rulemaking, while also recognizing that the undertaking did not resolve all uncertainty with respect to health care unit determinations:

> Finally, although we are highly satisfied with this rulemaking proceeding both because of the large amount of

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[81] Final Rule, *supra* note 7, at 16,338. The Board gave the following examples:

> (1) That single facility units are presumptively appropriate. Haag Drug Company, Inc., 169 NLRB 877 (1968). See also NLRB v. New Enterprise Stone & Lime Co., 413 F.2d 117 (3d Cir. 1969); (2) that residual units are not separately appropriate when sought by an incumbent. The Budd Co., 154 NLRB 421 (1965); (3) that plant clericals and office clericals do not constitute an appropriate unit absent agreement of the parties. The Kroger Co., 204 NLRB 1055 (1973); Robbin & Myers, Inc., 144 NLRB 295 (1963); (4) that the appropriate unit in decertification elections is the certified or recognized unit. Campbell Soup Co., 111 NLRB 234 (1955). See also the "rules" described in Otis Hospital, 219 NLRB 164, 166 (1975), pertaining to the appropriateness of residual units in the health care industry. Id.

[82] 461 U.S. 458 (1983).

[83] The notice quotes from *Heckler v. Campbell*:

> We do not think that the Secretary's reliance on medical-vocational guideline is inconsistent with the Social Security Act. It is true that the statutory scheme contemplates that disability hearings will be individualized determinations based on evidence adduced at a hearing. See 42 U.S.C. sec. 423(d)(2)(A) (specifying consideration of each individual's condition); 42 U.S.C. sec. 405(b) (1976 ed., Supp. V) (disability determination to be based on evidence adduced at hearing). But this does not bar the Secretary from relying on rulemaking to resolve certain classes of issues. The Court has recognized that even where an agency's enabling statute expressly requires it to hold a hearing, the agency may rely on its rulemaking authority to determine issues that do not require case-by-case consideration. See FPC v. Texaco Inc., 377 U.S. 33, 41-44 (1964); United States v. Storer Broadcasting Co., 351 U.S. 192, 205 (1956). A contrary holding would require the agency continually to relitigate issues that may be established fairly and efficiently in a single rulemaking proceeding. See FPC v. Texaco Inc., *supra*, at 44. Final Rule, *supra* note 7, at 16,338.

> valuable information it has given us and because, based on that information, we are confident we have moved towards eliminating much of the unnecessary uncertainty existing in this area, we are under no illusions that the answers we now provide will necessarily solve all health care unit problems, for all time. This is our first venture in major, substantive rulemaking. At some future date, after the rule has had a fair trial, it may be appropriate to reexamine the rule to determine how well it has worked, whether new developments have changed our underlying assumptions and require different conclusions, and whether some other provisions might improve those now promulgated.[84]

The final rule maintained the eight-unit structure proposed in NPR II. The rule also included, for the first time, definitions of: "hospital," "acute care hospital," "psychiatric hospital," and "rehabilitation hospital." Finally, and most importantly, the rule added a proviso that "a unit of five or fewer employees shall constitute an extraordinary circumstances," and thus under the rule is a case in which "the Board shall determine...by adjudication."[85]

The final notice also contained a reaffirmation of a certification made in NPR II under the Regulatory Flexibility Act.[86] NPR I did not contain a

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[84] Final Rule, *supra* note 7, at 16,339.

[85] Final Rule, *supra* note 7, at 16,341-42. The Board explained:

> A number of commenters argue that the proposed "skilled maintenance" and "other professional" units, in particular, may be too small for collective bargaining purposes.
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> * * *
>
> We recognize the possibility that some skilled maintenance units will be relatively small, as will some "other professional" units and some physicians' units. The same point has been made with respect to rural hospitals, whose small employee complements may also lead to very small units.
>
> * * *
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> . . . [D]espite the improbability that the problem will frequently arise, we agree that units of two or three employees, or of similarly small numbers of employees, would in many cases be impractically small, especially in the health care industry. Where so few employees are involved, it can be argued with some degree or persuasiveness that despite the shared, unique concerns and backgrounds that would otherwise make the separate units appropriate, these concerns are outweighed by concerns over disproportionate, unjustified costs and undue proliferation of units. We therefore shall revise the rule to provide that a petitioned-for unit of five employees or fewer shall constitute an "extraordinary circumstance" removing the case from strict application of the rule, and the Board will consider by adjudication what the appropriate scope of the unit should be. Id.

[86] Final Rule, *supra* note 7, at 16,346. The certification in NPR II read as follows:

Regulatory Flexibility Act certification. The desire to correct this omission may also have been part of the motivation for providing, in NPR II, an additional comment period.

Member Johansen dissented formally, as he had done in NPR II. He took the position that rulemaking for determining health care units was both inappropriate and undesirable. He first argued that the "in each case" language of section 9(b) foreclosed rulemaking for particular units. He then argued that even if promulgation of such a rule was a permissible exercise it would not resolve the disagreement that existed in the Board and in the courts over the meaning of the 1974 health care amendments, a matter that should be resolved by a definitive Supreme Court ruling. Finally, he argued that neither could the health care industry tolerate the rigidity of the rule, nor could the Board sustain the inflexibility of the rule in light of the evidence it had received and the changes it had felt necessary to make over the course of the rulemaking.

## VI. Litigation Challenging the Rule

The rule was to become effective May 22, 1989, 30 days after the publication of the final rule on April 21, 1989. On April 21, the American Hospital Association (AHA), a trade association representing over 5,000 hospitals, filed an action in the United States District Court for the Northern District of Illinois challenging the rule and seeking declaratory and injunctive relief. On May 22, 1989 District Judge James Zagel issued a preliminary injunction against enforcement of the rule and, on July 25, 1989, declared the rule unlawful and granted a permanent injunction. On April 11, 1990, the United States Court of Appeals for the Seventh Circuit reversed in an opinion by Judge Richard Posner, joined by Judges Kenneth Ripple and Michael Kanne. On May 3, 1990 the court of appeals granted the motion of the AHA to stay the order vacating the district court order, pending the filing and disposition of an AHA petition for certiorari in the Supreme Court. On July 10, 1990, the AHA filed a petition for certiorari. On September 6, 1990, the

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> As required by the Regulatory Flexibility Act, 5 U.S.C. 601 et seq., the Board certifies that the proposed rule will not have a significant economic impact on small entities. Prior to this rule, parties before the Board were required to litigate the appropriateness of a unit for election purposes if they could not reach agreement on the issue. Upon enactment of this rule, parties will no longer be required to engage in litigation to determine the appropriateness of units, thereby saving all parties the expense of litigation before the Board and the courts. To the extent that organization of employees for the purpose of collective bargaining will be fostered by this rule, thereby requiring small entities to bargain with unions, and that employees may thereby exercise rights under the National Labor Relations Act, as amended (29 U.S.C. 151 et seq.), the Board notes that such was and is Congress' purpose in enacting the Act and the health care amendments thereto. NPR II, *supra* note 61, at 33,934.

Board filed a brief in response, not opposing the granting of certiorari. On October 9, 1990, the Supreme Court granted the petition. On November 21, 1990, and January 3, 1991, the AHA and the Board, respectively, filed briefs on the merits. On February 25, 1991, the case was argued and, on April 23, 1991, the Supreme Court affirmed the Court of Appeals.

## A. District Court Proceeding

Upon issuing the preliminary injunction on May 22, 1989, the District Court set an expedited briefing schedule for the hearing on the permanent injunction. In the District Court, the AHA argued: (1) that the "in each case" language of section 9(b) of the Act precluded the use of rulemaking to define units, (2) that the rule contravened the congressional admonition against "undue proliferation" in health care units, (3) that the rule was arbitrary and capricious and was not supported by substantial evidence. The Board, apart from opposing the three AHA arguments on the merits, also argued that the district court lacked jurisdiction to review the regulation, either because (like a Board certification of an appropriate bargaining unit) it was not a "final order" within the NLRA scheme[87] or because the case was not ripe.[88] On July 25, 1989, the District issued the permanent injunction against the rule.[89] After disposing of the Board's jurisdictional objection,[90] the court rejected the argument that the "in each case" language forecloses the Board entirely from rulemaking with respect to unit determinations. It instead held that any rule that "designates an absolute number of appropriate units" for health care institutions is inconsistent with the congressional admonition against undue proliferation. Having concluded that the rule was unlawful on this ground, the court found it unnecessary to consider the AHA argument that the rule was arbitrary and capricious.

The Board had expected to process under the rule all covered health care petitions filed on and after its effective date. The preliminary injunction, issued on the day the rule would have become effective, required the Board to establish an alternative policy to apply during the pendency of the litigation.

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[87] In support of this position, the Board relied upon *Boire v. Greyhound Corp.*, 376 U.S. 473 (1964); Leedom v. Kyne, 358 U.S. 184 (1958); and American Fed'n of Labor v. NLRB, 308 U.S. 401 (1940).

[88] In support of this position the Board relied upon *Abbott Laboratories v. Gardner*, 387 U.S. 136 (1967) and its progeny.

[89] American Hospital Ass'n v. National Labor Relations Bd., 718 F. Supp. 704 (U.S.D.C. N.D. Ill. 1989).

[90] The Board abandoned these jurisdictional arguments on appeal.

In *St. Vincent*, as noted earlier, the Board had indicated that during the pendency of the rulemaking, it would continue to process election petitions under the prior standards. Despite the availability of the election process during rulemaking hardly any petitions were filed, presumably because for many key health care unions the standards of the proposed rule were more favorable and minimized the risk of litigation delays. This suggested that a number of health care unions had simply delayed petitions or further organizing efforts pending the completion of the rulemaking. Thus, the Board faced a dilemma. Either it would have to continue to process petitions under the prerule standards which were now arguably inconsistent with the position it had taken in the rulemaking, or it would have to suspend processing petitions while it sought to have the injunction overturned. It chose essentially the latter course.

On May 30, 1989, 8 days after the District Court issued its preliminary injunction, Acting General Counsel Joseph Desio issued a memorandum in which he advised regional office to take the following steps:

> 1. If the proposed health care unit does not involve an acute-care hospital, the Region should continue to process these cases. An acute-care hospital is defined [by] the Final Rule, and excludes facilities that are "primarily nursing homes, primarily psychiatric hospitals, or primarily rehabilitation hospitals."
>
> 2. If the proposed unit involves an acute-care facility, and the unit would be appropriate under *St. Francis* and *St. Vincent* the Region should continue to process these cases.
>
> 3. If the employer is an acute-care facility and the petition seeks a separate unit for registered nurses, doctors, skilled maintenance employees or business office clericals, i.e., the case would be decided differently under the Final Rule than under *St. Vincent*, and the Region cannot secure a stipulation as to the unit, please defer processing the petition pending further notice.[91]

Because almost all "delayed" petitions would have fallen into the third category (i.e., those for which the rule would have produced a different outcome), the Desio memorandum for all practical purposes stopped the processing of petitions in covered health care institutions. Thus, the ironic effect of the issuance of the final rule coupled with the issuance of the preliminary injunction and the Desio memorandum was effectively to bring to a halt formal organizing activities in acute care hospitals, the most prominent part of the health care industry.

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[91] Gen. Couns. Mem. 89-70 (May 30, 1989) (citations omitted).

On July 31, the Board filed its notice of appeal of the District Court decision. The Board requested, but was denied, an expedited appeal.[92] While the immediate object of the Board was to overturn promptly the District Court decision, there was a further concern. Health care industry representatives suggested that if the District Court decision was overturned (or even if the District Court had decided in favor of the Board) further actions challenging the rule would be filed in other districts throughout the country.[93] Because the National Labor Relations Act does not specify the method for judicial review of a Board rule, review could be had by way of an action for declaratory and injunctive relief in virtually any United States district court--traditional "non-statutory" review.[94] It was relatively clear, however, that members of the AHA would be barred, under the "association representation" branch of the preclusion doctrine, from bringing any such subsequent action.[95] Yet it was quite unclear whether the numerous hospitals which were not members of the AHA would be barred under the "virtual representation" branch of that doctrine.[96] The uncertainty and confusion that would have been created by successive actions challenging the rule was resolved in this case when the

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[92] The order denying the expedited appeal was entered on August 16, 1989.

[93] For example, hospital attorney Roger King had stated:

> [H]ospitals are entitled to challenge the rules in 47 other states. Until the Supreme Court ultimately passes on the validity of the unit determination rules...we will proceed in our client's representation cases in precisely the same way as we have done so in the past.

Reported in *Modern Healthcare*, April 23, 1990, at 3.

This position was relied upon by the American Hospital Association in its petition for certiorari. Petition for Certiorari, American Hospital Association v. NLRB, (No. 90-97) at 28-30.

[94] The presumption of reviewability of final agency action, see Administrative Procedure Act §§701, 702, and 704, and *Abbott Laboratories v. Gardner*, 387 U.S. 136 (1967), coupled with the availability of broad jurisdictional provisions such as 28 U.S.C. 1331 (federal question) or 28 U.S.C. 1337 (questions arising under statutes regulating commerce) provide a basis for review of agency rulemaking even where the statutory granting rulemaking authority does not provide specifically for review of final rules.

[95] See, *Western Coal Traffic League v. ICC*, 735 F.2d 1408, 1411 (D.C. Cir. 1984) (and cases cited therein). See also, 18 C. Wright, A. Miller & E. Cooper, Federal Practice and Procedure §4456 (1981 & 1990 Supp.).

[96] See, 18 C. Wright, A. Miller & E. Cooper, Federal Practice and Procedure §4457 (1981 & 1990 Supp.).

Supreme Court granted certiorari and was one of the factors that led the Board not to oppose the AHA petition for certiorari.[97]

## B. Court of Appeals Proceeding

The Court of Appeals decision on April 11, 1990 came nearly 1 year after publication of the final rule. The decision reversed the district court, vacated the injunction, and directed the district court to enter judgment for the Board.[98] Nevertheless, on May 3, as noted earlier, the court granted the motion of the AHA to have its order stayed pending the filing and disposition of the AHA's petition for certiorari.[99]

The opinion, written by Judge Posner, first rejected the argument that the "in each case" language of 9(b) barred the rule:

> The reference in section 9(b) to employer, craft, and plant units suggests that the term "in each case" was included to prevent the Board from bringing about a revolution in unit determinations by prescribing employer units, or craft units, or plant units for all employers under the Board's jurisdiction....But it is consistent with the background and semantics of the proviso that a "case" can be an industry or (as here) a subset or submarket of an industry; it need not be a particular dispute between a particular employer and a particular union at a particular plant or establishment.
>
> Another possibility is that "in each case" simply expresses the truism that, whether or not the Board proceeds by formal rulemaking, it still must determine the bargaining units in each case in which there is a dispute over how to classify particular workers. In other words, a rule, like a statute, is applied case by case. Still another possibility is that "case" means "proceeding" in a sense broad enough to cover a rulemaking proceeding as well as an adjudicative one.[100]

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[97] Brief for the National Labor Relations Board (On Petition for Certiorari), American Hospital Association v. NLRB (No. 90-97) at 15-16.

[98] American Hospital Ass'n v. National Labor Relations Bd., 899 F.2d 651 (7th Cir. 1990).

[99] Stay Order, May 3, 1990, American Hospital Association v. NLRB, Nos. 89-2604, 89-2605, and 89-2622 (7th Cir.). See also, Daily Labor Report, No. 88, p. A-12 (May 7, 1990) and No. 104, p. A-10 (May 30, 1990).

[100] 899 F.2d 651 at 656.

The opinion went on to find that none of these interpretations was inconsistent with the "scant" legislative history of the provision.

The opinion also rejected the argument that the rule was inconsistent with the so-called "non-proliferation" mandate included in the House and Senate committee reports:

> Ordinarily a committee report that is not explaining new or altered statutory language has little significance in the interpretation of a statute....Congress legislates by passing bills and sending them to the President for his signature. It does not legislate by issuing committee reports. Post-enactment legislative history...is sometimes a sneaky device for trying to influence the interpretation of a statute, in derogation of the deal struck in the statute itself among the various interests represented in the legislature.
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> * * *
>
> The admonition in the 1974 committee reports is certainly not a statute, and courts that have treated it as such have in our view erred. The admonition lies between the polar cases of a committee report that does not accompany legislative action and a committee report that explains a newly enacted or amended statute, but is we think closer to the latter....The admonition can therefore be regarded as a commentary on the meaning of the 1974 amendments and hence as equivalent to pre-enactment legislative history, rather than as a gratuitous comment unrelated to legislative action.
>
> And yet the fact that the hospital industry would have dearly loved to amend the unit-determination provision yet failed to do so must give us pause in treating the "admonition" as if it were a statute, which anyway it plainly is not. To treat it as one would give the hospital industry something it tried and failed to win from Congress. Moreover the admonition does not read like a statute. It is cautionary rather than directive....[S]uch an expression is entitled to our respectful consideration, not only for its intrinsic merits but also for what light it sheds on Congress' intentions in the 1974 amendments. But it is not an amendment to section 9(b),

> decreeing that in the health-care industry no more than three separate bargaining units shall be authorized.[101]

Finally, the opinion rejected the AHA argument that the rule was arbitrary and capricious because it treated identically hospitals of different sizes and missions in different locations:

> The lumping together of all acute-care hospitals into one category for purposes of prescribing proper bargaining units does of course overlook a great deal of relevant diversity. What the hospital industry refuses to acknowledge is that this is the very nature of rules. A rule makes one or a few of a mass of particulars legally decisive, ignoring the rest. The result is a gain in certainty, predictability, celerity, and economy, and a loss in individualized justice. Often the tradeoff is worthwhile; at least the prevalence of rules in our legal system so suggests. The hospital industry is acutely conscious of the costs of rules, but disregards the benefits.
>
> For its first 44 years the Board tried to channel its discretion over unit determination in common law fashion, proposing and modifying standards case by case. That was the approach it took when the nonprofit health care sector was brought under its aegis in 1974. The approach is widely regarded as a failure....Against this dismal background it was not unreasonable for the Board to experiment with substituting a tight rule for a loose standard....It gave plausible reasons for its choice.
>
> * * *
>
> It is not for us to fine-tune the regulatory process by telling the Labor Board that its rule should make slightly more distinctions than it does, or slightly fewer. The Board did a responsible job of weighing the conflicting arguments, and we therefore uphold its rule without pretending that we consider it Utopia.[102]

Thus, while the Board prevailed on all three issues before the Court of Appeals, the court's subsequent stay order left the Board with a still unenforceable rule. Under the terms of the order, vacation of the injunction was stayed pending disposition of the case in the Supreme Court.[103]

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[101] Id. at 657-59.

[102] Id. at 659-60.

## C. Supreme Court Proceeding

The brief of the AHA in the Supreme Court maintained all three formal arguments that had been made in the courts below, but focused on two themes that cut across the three arguments.[104] First, the brief emphasized the "rigidity" of the rule in the face of "diversity" in the health care industry and in light of the congressional nonproliferation admonition. Thus, rather than attacking broadly the legal authority of the Board to use rulemaking, or even its authority to use rulemaking in some fashion for unit issues, the brief argued that the outcome-determinative character of this rule precluded the Board from taking into account individual case differences as required by the "in each case" language. Second, the brief urged that the use of rulemaking for health care unit determinations, as well the rule itself, represented an abrupt and insufficiently explained departure from prior Board policy. This theme drew not only upon the Board's commitment to the adjudicative approach in its prior health care unit decisions, but also upon prior Board statements concerning diversity in the health care industry as it affected unit determinations and prior Board decisions arguably inconsistent with the substance of the rule.

The broad theme of the Board's response to the AHA arguments echoed Judge Posner's conclusion: the rule warranted judicial respect as the careful and sensible product of a public process that will enable the agency to function more fairly and efficiently by narrowing and defining the scope of issues that must be adjudicated.[105] The Board's brief maintained that the "in each case" language simply ensured that an individualized proceeding would be available for the application of any rules (whether formulated in a rulemaking or an adjudication) that were relevant in a particular case. The brief defended the health care unit rule, and the proceeding underlying it, as reflecting fully "due consideration" of the issue of proliferation of bargaining units contained in the congressional admonition and as fully explaining any departure from prior policy.

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[103] See *supra* note 97.

[104] Brief of the American Hospital Association, *American Hospital Association v. NLRB* (No. 90-97).

[105] Brief of the National Labor Relations Board, *American Hospital Association v. NLRB* (No. 90-97).

In oral argument, the AHA concentrated exclusively on the import of the "in each case" language.[106] It asserted that the rule left nothing for the Board to determine "in each case," because even the exception for "extraordinary circumstances" was so narrowly drawn as to be "illusory." Questioning from the Court required counsel for the AHA to distinguish between this use of rulemaking and widely accepted uses of rulemaking that limit hearing rights, including "rules" formulated by the Board in adjudications. While AHA counsel sought to differentiate the health care unit rule by arguing that other rules left more room for case-by-case determination, at bottom the AHA position was that the "in each case" language of the Act uniquely limited the power of the Board to make outcome-determinative rules on unit questions.

In response, the Board argued not only that the critical statutory language was not a substantive limit on it rulemaking authority, but also that even in processing petitions under the health care rule it would be necessary to make individualized determinations, most obviously that the petitioned-against party was in fact an "acute care hospital." Counsel for the Board did not, however, attempt to argue that the rule satisfied the "in each case" language because it provided an exception for "unusual circumstances." Instead, counsel essentially conceded the narrowness of the exception, and in response to a question from the court asserted that the rule would be valid even without the exception. Board counsel also addressed the "congressional admonition" and "arbitrary and capricious" arguments that the AHA had raised in its brief but had not pursued in oral argument.

On April 23, 1991, just under 2 months after oral argument in the case, a unanimous Court, speaking through Justice Stevens, affirmed the Court of Appeals.[107] In upholding the validity of the rule, the Court reasoned that the Board's general rulemaking authority "was unquestionably sufficient to authorize the rule...unless limited by some other provision in the Act."[108] Turning to the "in each case" language, the Court rejected the AHA reading of the provision as such a limit:

> Although the contours of the restriction that petitioner ascribes to the phrase are murky, petitioner's reading of the language would prevent the Board from imposing any industry-wide rule delineating the appropriate bargaining units.

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[106] See, Daily Labor Report, No. 38, p. A-5 (February 26, 1991).

[107] American Hospital Association v. National Labor Relations Board, 59 U.S.L.W. 4331 (1991).

[108] Id. at 4332.

> The more natural reading of these three words is simply to indicate that whenever there is a disagreement about the appropriateness of a unit, the Board shall resolve the dispute. Under this reading, the words "in each case" are synonymous with "whenever necessary" or "in any case in which there is a dispute." Congress chose not to enact a general rule that would require plant unions, craft unions or industry-wide unions for every employer in every line of commerce, but also chose not to leave the decision up to employees or employers alone. Instead, the decision "in each case" in which a dispute arises is to be made by the Board.
>
> In resolving such a dispute, the Board's decision is presumably to be guided not simply by the basic policy of the Act but also by the rules that the Board develops to circumscribe and to guide its discretion either in the process of case-by-case adjudication or by the exercise of its rulemaking authority.[109]

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[109] Id. at 4332-33. As had the Board, the Court quoted Professor Davis' conclusion that the statutory language "does not prevent the Board from supplanting the original discretionary chaos with some degree of order." See, *supra*, note 56 and accompanying text. The Court continued:

> This reading of the "in each case" requirement comports with our past interpretations of similar provisions in other regulatory statutes. See United States v. Storer Broadcasting Co., 351 U.S. 192, 205 (1956); FPC v. Texaco, Inc., 377 U.S. 33, 41-44 (1964); Heckler v. Campbell, 461 U.S. 458, 467 (1983). These decisions confirm that, even if a statutory scheme requires individualized determinations, the decisionmaker has the authority to rely on rulemaking to resolve certain issues of general applicability unless Congress clearly expresses an intent to withhold that authority.
>
> Even petitioner acknowledges that "the Board could adopt rules establishing general principles to guide the required case-by-case bargaining unit determinations." Brief for Petitioner 19. Petitioner further acknowledges that the Board has created many such rules in the half-century during which it has adjudicated bargaining unit disputes. Reply Brief for Petitioner 8-11. Petitioner contends, however, that a rule delineating the appropriate bargaining unit for an entire industry is qualitatively different from these prior rules, which at most established rebuttable presumptions that certain units would be considered appropriate in certain circumstances.
>
> We simply cannot find in the three words "in each case" any basis for the fine distinction that petitioner would have us draw. Contrary to petitioner's contention, the Board's rule is not an irrebuttable presumption; instead, it contains an exception for "extraordinary circumstances." Even if the rule did establish an irrebuttable presumption, it would not differ significantly from the prior rules adopted by the Board. As with its prior rules, the Board must still apply the rule "in each case." For example, the Board must decide in each case, among a host of other issues, whether a given facility is properly classified as an acute care hospital and whether particular employees are properly placed in particular units.

The Court went on to find that both the "structure and policy" of the Act as well as the legislative history of the unit determination provision "reinforced" this view of the statutory language. Had the term "in each case" been intended to limit the broad section 6 rulemaking authority of the Board, the Court reasoned, Congress would have been "expected to do so in language expressly describing an exception from that section or at least referring specifically to the section."[110] Likewise, if the provision "had been intended to place an important limitation on the scope of the Board's rulemaking powers," the legislative history would have been expected to contain "some expression of that intent."[111] Citing *Chevron USA Inc. v. Natural Resources Defense Council*,[112] the Court concluded by observing that "[e]ven if we could find any ambiguity in §9(b) after employing the traditional tools of statutory construction, we would still defer to the Board's reasonable interpretation of the statutory text."[113]

The Court also rejected the various forms of the AHA argument that the congressional admonition created a judicially enforceable standard for Board health care units determinations. It read the admonition as:

> an expression by the Committees of their desire that the Board give "due consideration" to the special problems that "proliferation" might create in acute care hospitals. Examining the record of the Board's rulemaking proceeding, we find that it gave extensive consideration to this very issue.
>
> In any event, we think that the admonition in the Committee Reports is best understood as a form of notice to the Board that if it did not give appropriate consideration to the problem of proliferation in this industry, Congress might respond with a legislative remedy.... If Congress believes that the Board has not given "due consideration" to the issue, Congress may fashion an appropriate response.[114]

Finally, the court rejected the AHA argument that the rule was arbitrary and capricious because it "ignores critical differences among the more than 4,000 acute-care hospitals in the United States," some of which the Board had acknowledged in unit adjudications:

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Id. at 4333.

[110] Id.

[111] Id.

[112] 467 U.S. 837, 842-43 (1984).

[113] 59 U.S.L.W. 4333 (1991).

[114] Id. at 4334.

> Given the extensive notice and comment rulemaking conducted by the Board, its careful analysis of the comments that it received, and its well-reasoned justification for the new rule, we would not be troubled even if there were inconsistencies between the current rule and prior NLRB pronouncements. The [statute] ...contemplates the possibility that the Board will reshape its policies on the basis of more information and experience in the administration of the Act. The question whether the Board has changed its view about certain issues or certain industries does not undermine the validity of a rule that is based on substantial evidence and supported by a "reasoned analysis."
>
> * * *
>
> The fact that petitioner can point to a hypothetical case in which the rule might lead to an arbitrary result does not render the rule "arbitrary or capricious." This case is a challenge to the validity of the entire rule in all its applications. We consider it likely that presented with the case of an acute care hospital to which its application would be arbitrary, the Board would conclude that "extraordinary circumstances" justified a departure from the rule. Even assuming, however, that the Board might decline to do so, we cannot conclude the entire rule is invalid on its face.[115]

By rejecting all three arguments of the AHA, the Court not only put to rest the question of the validity of the health care unit rule, but also resolved authoritatively the significance of the congressional admonition with respect to proliferation of health care units and the power of the Board to use rulemaking generally and for unit issues particularly.

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[115] 59 U.S.L.W. 4331 at 4334, citing Motor Vehicle Mfrs. Assn. v. State Farm Mutual Automobile Ins. Co., 463 U.S. 29, 42, 57 (1983). Addressing the Board's attention in the rulemaking to the issue of diversity in the health care industry, the Court observed:

> The Board's conclusion that, absent extraordinary circumstances, "acute care hospitals do not differ in substantial, significant ways relating to the appropriateness of units," was based on a "reasoned analysis" of an extensive record. The Board explained that diversity among hospitals had not previously affected the results of bargaining unit determinations and that diversification did not make rulemaking inappropriate. The Board justified its selection of the individual bargaining units by detailing the factors that supported generalizations as to the appropriateness of those units.

Id. (citation omitted).

## VII. Evaluation

Any evaluation of these events must begin with the observation that the first major substantive use of rulemaking by the NLRB is, without more, a matter of some significance for both administrative practice generally and national labor policy particularly. Symbolically, a barrier has fallen. An agency which for more than 50 years abjured a policy-making technique that is one of the hallmarks of American administrative practice has shed its curmudgeonly procedural image. Labor policy, if only in a single instance, has been influenced by the form and character of public participation that notice-and-comment rulemaking provides. Yet does this historic event mark a turning point in Board policy and practice? That question is divided into several subquestions below. Some tentative, and admittedly somewhat speculative, answers are offered.

### A. Why Now?

First, to what extent was the Board's willingness to pursue a new policy-making technique influenced by the particularly difficult policy dilemma it faced after a 13 year struggle with the health care amendments and the decision of the D.C. Circuit in *St. Francis II*? Clearly, this was an important factor. Any prospect for a fresh approach would have seemed attractive. While seeking Supreme Court review in an adjudication was certainly a possibility, that approach would have bound the Board to defending a policy about which some members may have had lingering doubts and would, given the mixed results in the circuits and subtle distinctions in a number of Board decisions, have risked surrendering to the Supreme Court some relatively important policy choices. Nevertheless, this was not the only difficult policy issue facing the Board in mid-1987 and, given the controversy it had generated, was an especially complex and risky problem on which to experiment with an untried policymaking device.

What else, then, may have influenced the Board to proceed by rulemaking? Beginning in the early 1980s, labor leaders became increasingly vocal and direct in their criticism of evolving Board policy that they perceived to be hostile to unions. By the time the health care rulemaking was begun, labor had demonstrated its displeasure with Board policy under some circumstances by avoiding use of Board processes. Board caseload, as well as Board credibility with an important part of its regulated constituency, was affected. While, as noted earlier, a rulemaking posed the risk for unions of locking in unfavorable policy, it also offered the prospect of reducing delays in accomplishing representation by limiting the opportunities for litigation. It is thus possible that the Board decision to undertake rulemaking was intended, in part, by some members as an invitation to an estranged constituency to return to the regulatory process.[116]

In fact, it appears that both the pressing need for a clean solution to the health care unit issue, as well as a desire to improve relations with a major constituency, influenced the Board to some extent. But ultimately, the factor that may have tipped the balance in favor of a decision to proceed was staff initiative. In 1981 the Director of the Office of Representation Appeals, Berton Subrin, had written an article[117] suggesting the desirability of using rulemaking to resolve unit issues. At the point the Board was forced to confront *St. Francis II* on remand, Subrin presumably was still persuaded of the utility of rulemaking and was in the position to convey his views to the Board.[118]

If the coincidence of these three factors led to the initiation of the rulemaking, will further Board rulemaking await a similarly compelling set of circumstances? Perhaps, but the fact that the process has now been used eliminates a significant aspect of the inertia which serves to inhibit agency experimentation of this sort. A far more important factor bearing on the likelihood of further Board rulemaking will be the implicit cost-benefit analysis that both members and staff will undertake when the rule becomes effective.

## B. Did It Work?

Undoubtedly, an important element in this cost-benefit analysis is the reaction of the Supreme Court to the Board's initiative. Both symbolically and practically, an adverse Supreme Court decision would have been devastating for the forces within the Board which might stimulate further use of rulemaking. The breadth and clarity of the Supreme Court's approval of the rule suggests a strong, if inexplicit, endorsement of rulemaking as useful policymaking vehicle for the Board.[119]

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[116] See, *supra* note 65 and accompanying text.

[117] Subrin, *supra* note 3.

[118] E.g., Subrin participated in the two open meetings of the Board held prior to the issuance of the notice of proposed rulemaking. Meetings of May 15 and June 9, 1987.

[119] While the opinion contains no explicit praise for the Board's turn to rulemaking for policy formulation nor encouragement to continue in that direction, the Court's unequivocal validation of the rule despite industry arguments of critical economic implications conveys respect for the effort to resolve a difficult policy issue through a previously avoided policymaking device.

An equally important element is also a particularly speculative one: will the rule in fact reduce litigation and delay in representation proceedings? Until the rule is allowed to operate for a period, this question can not be answered reliably. Nevertheless, the prognosis for the rule seems good. The terms of the rule are clear and straightforward; the rule *establishes* appropriate units; its does not merely set standards for units or presume certain units to be appropriate. Although the rule has an "extraordinary circumstances" exception, the Board has made clear that it intends to construe this provision narrowly and that the process for testing out the applicability of the exception to particular cases will not itself be delay-inducing.[120] The most likely problem would be a shift in management litigation focus from questions of the appropriateness of particular units to questions of "placement" of employees in concededly appropriate units (i.e., in which units do employees performing a particular set of duties belong?). At least with respect to acute care hospitals,

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The closing paragraph of the opinion, while separating the Court from the substance of the policy, recognizes decisively the authority of the Board to make such policy choices through rulemaking:

> In this opinion, we have deliberately avoided any extended comment on the wisdom of the rule, the propriety of the specific unit determinations, or the importance of avoiding work stoppages in acute care hospitals. We have pretermitted such discussion not because these matters are unimportant but because they primarily concern the Board's exercise of its authority rather than the limited scope of our review of the legal arguments presented by petitioner. Because we find no merit in any of these legal arguments, the judgment of the Court of Appeals is affirmed.

59 U.S.L.W. at 4335.

[120] In NPR II, the Board explained:

> To satisfy the requirement of "extraordinary circumstances," a party would have to bear the "heavy burden" to demonstrate that "its arguments are substantially different from those which have been carefully considered at the rulemaking proceeding," as, for instance, by showing the existence of such unusual and unforeseen deviations from the range of circumstances revealed at the hearings and known to the Board from more than 13 years of adjudicating cases in this field, that it would be unjust or an abuse of discretion for the Board to apply the rules to the facility involved.
>
> The Board, contrary to some industry representatives anticipates that litigation under the "extraordinary circumstances" exception will be rare; the AHA, representing the largest group of health care employers in this proceeding, has indicated it understands that the Board intends to limit exceptions to "truly extraordinary situations," and neither the AHA nor any other employer (or union) representative has raised objections to the Board's stated intent.
>
> In most instances, should a facility claim it comes within the "extraordinary circumstances" exception, it should present an offer of proof to the Hearing Officer, who will then either permit the requested evidence to be adduced or, we anticipate far more commonly, refer the offer to the Regional Director, and, if requested, ultimately to the Board, for ruling. NPR II, *supra* note 61, at 33,932-33.

the Board apparently believes these are manageable issues and seems prepared to respond to attempts to upset the rule's implementation with such tactics.[121]

Assuming the rule can be efficiently implemented, the question then becomes what were the costs to the Board in promulgating the rule. Almost 2 years elapsed between May 15, 1987, when the Board decided to engage in rulemaking and April 21, 1989, when it issued the final rule. During this period, substantial staff time, including high-level staff, was used to manage the rulemaking and to assist in the analysis of the product of the hearings and other comment periods. The novelty of the proceeding for the Board meant that some of this time was spent developing new procedural expertise, but a large part of the time was devoted to dealing with the hearing and comment process, with a large rulemaking record, and with relatively complex substantive issues. Not only was the time commitment significant as an absolute matter, but also because regular staff rather than special rulemaking staff was used, this staff time was invested at a cost to other matters. Nevertheless, efficient implementation of the rule should lead to offsetting staff time savings through straightforward application of the rule for unit determinations rather than staff involvement in the previously required litigation.

Moreover, a portion of the 2 years was consumed with a procedure not required for notice-and-comment rulemaking--multi-location hearings with an opportunity for a form of cross-examination. The possible Board rationales for using such hearings and the burdens and benefits of the hearings have been noted earlier. Under the circumstances of this rulemaking, particularly its novelty for the Board, the hearings were probably a desirable choice. Certainly as a legal matter, however, and perhaps as a practical matter, the hearings were procedural overkill and would have to be considered as part of the overall cost-benefit evaluation of the rulemaking.

Finally, the post-issuance litigation challenging the rule and the effect of that litigation on implementation of the rule is a necessary part of the evaluation. As noted earlier, in *St. Vincent* the Board decided that during the pendency of the rulemaking, the prior standards for unit determinations would apply so that petitions could continue to be processed. Apart from the strategic withholding of petitions by unions which anticipated more favorable opportunities after the issuance of a rule, the business-as-usual approach was reasonable and had no further cost. But clearly the Board anticipated that as soon as the rule became effective, it would be implemented. When the district court enjoined enforcement of the rule, the Board faced a new cost. It effectively chose to suspend processing health care petitions rather than to attempt to defend possibly inconsistent positions: the old vs. the new standards. The consequence has been that for a period of almost 2 years few acute care hospital petitions have been processed. It must be recognized, however, that Supreme Court review was responsible for a substantial portion of the delay and would not likely be a part of future rulemakings. Nevertheless, in this case, the rulemaking and judicial review consumed over 3-1/2 years and have had an effect on the normal representation process at the Board. Furthermore, the prospect of successive challenges to the rule throughout the country loomed as an additional barrier to implementation of the rule and was put to rest only after the Supreme Court granted the petition for certiorari.[122]

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[121] Id.

### C. What was learned?

Putting aside the yet unknowable effect the rule will have when implemented, it seems clear that the proceeding accomplished the major putative purposes of rulemaking. First, the Board accumulated an enormous volume of empirical data that simply had not been available to it in adjudications, and it thoroughly digested that information and used it effectively in formulating the final rule. Second, the process provided a degree of openness and broad scale participation simply unmatched by the even the most open traditional Board proceedings--oral arguments with representative *amici*. Third, the product of the rulemaking is a model of clarity as expression of policy in an area that had historically been consumed by excessive subtlety and complexity. Finally, the rule, promises a degree of stability for a policy area that had been overwhelmed by change. In short, the case can be made, in the words of Professor Morris, that the "old Board has learned a new trick."[123]

## VIII. Conclusion and Recommendations

Faced with a difficult and lingering policy question, the Board chose boldly to experiment with a policy-making device previously untried in the agency. It cannot be said, however, that the choice represented a broad new commitment to formulating national labor policy through rulemaking. This rulemaking was an exercise in pragmatism--a thorough, careful, and productive administrative response to a particular set of circumstances. Nevertheless, the rulemaking gives the Board experience upon which it can build. Much depends upon the outcome of the pending litigation; and assuming the result is favorable for the Board, more yet depends upon the success of the rule in accomplishing the objectives the Board sought through rulemaking. In the interim, however, there are steps that could be taken that may enhance the prospects for further Board rulemaking.[124]

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[122] A Supreme Court decision on the merits in this case would, of course, only resolve the validity of this rule; any further Board rulemaking would remain subject to the same prospect for delay.

[123] Morris, *supra* note 3.

The most formal of these would be to amend the National Labor Relations Act to provide specifically for preenforcement judicial review of a final Board rule. The objective would be to confine review to a single proceeding, thus avoiding the confusion and inefficiency of serial challenges to a rule. The simplest and most traditional provision along this line would authorize an exclusive proceeding in any one of the United States Courts of Appeals.[125] Consistent with well-recognized needs for prompt and comprehensive review when rules having broad national impact are challenged, the provision should also impose a time limit on seeking preenforcement review and should preclude review in enforcement proceedings of questions of (1) whether the rule was within the authority of the Board, (2) whether procedural requirements for the rulemaking were satisfied, and (3) whether there was adequate support for the rule in the rulemaking record.[126]

While there is no apparent need to amend the National Labor Relations Act to provide a more detailed procedure for rulemaking than is provided by §553 of the Administrative Procedure Act, it would be desirable for the Board to develop a standard set of procedures for rulemaking that would be in place and understood should another proceeding be undertaken. In formulating such procedures, the Board should consider whether the hearing component of the health-care unit rulemaking yielded a form of participation and data that should be carried forward into future rulemakings or whether written comments and data would suffice.[127] Given the burdens the hearings imposed, and recognizing the procedural variations available even in a written comment process, there appears to be little reason for the Board to hold such hearings as a matter of course.

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[124] These measures must be coupled with a willingness on the part of at least a majority of the Board to use rulemaking. Three members of the current Board (Chairman Stephens and Members Cracraft and Devaney) supported the health care unit rulemaking. The position of the other two current members (Oviatt and Raudabaugh) on the use of rulemaking is not a matter of record.

[125] See Recommendation 75-3, "The Choice of Forum for Judicial Review of Administrative Action", 1 CFR §305.75-3 (1990).

[126] See, ACUS Recommendation 82-7, "Judicial Review in Enforcement Proceedings", 1 CFR §305.82-7 (1990). See also, Verkuil, *Congressional Limitations on Judicial Review of Rules*, 57 TULANE L. REV. 733 (1983).

[127] See Recommendation 76-3, Procedures in Addition to Notice and the Opportunity for Comment in Informal Rulemaking, 1 CFR §305.76-3 (1990).

Similarly, it is possible that further use of rulemaking would be a more realistic prospect for the Board, as an institutional matter, if there were a staff that could be called upon to provide support regardless of the particular subject of the rulemaking. Such a staff not only might provide support in ongoing proceedings, but also might be a source of substantive and procedural expertise in considering future rulemakings. The latter function is closely related to still another possible internal measure, suggested below, that could affect future Board use of rulemaking.

A regularized method for identifying manageable and timely subjects for possible rulemaking could facilitate this form of policymaking. The body of law represented by the cases adjudicated over the 55-year history of the Board is enormous and complex. Any notion that this entire body of law or even any substantial part of it can be reduced to useful rules through the rulemaking process is simply unrealistic. Yet by combining a staff, as suggested above, with an internal process for identifying and evaluating potential subjects for rulemaking, the Board could inform itself more fully of consequences of the procedural choices it inevitably makes when it consciously engages in policymaking.

Factors that should influence the selection of further subjects for rulemaking include not only the considerations traditionally posited in connection with agency choice between rulemaking and adjudication,[128] but also considerations unique to the Board's institutional structure and enforcement responsibilities.[129] Even where the choices for rulemaking seem obvious, for example in the troubled area of health care units, or perhaps in a new area of Board law like *Beck*,[130] something might be gained by preliminary staff investigation and analysis. This function could perhaps be performed adequately within existing staffs, but for purposes of obtaining a meaningful overview of rulemaking prospects a staff with no fixed substantive domain may offer an advantage.

Finally, in any instance in which the possible subject for rulemaking is one treated by existing Board law, as opposed to an entirely new subject, the Board faces a difficult choice if enforcement of the rule is enjoined during the review process. The Board will have committed itself to a position that may be inconsistent with its prior position, but one which it is then barred from implementing. Using, and defending use of, the prior position is difficult, but suspending action in an area pending final determination on a newly promulgated rule has its costs as well. While the effect of this scenario could vary depending on the particular rule at issue, and may be offset as well by a single statutorily-prescribed review proceeding as suggested above, it is a matter about which the Board should formulate a general policy. Given its broad enforcement responsibilities, the Board should ordinarily continue to apply existing law during the pendency of a rulemaking as it did with health care unit determinations. Yet once a rule is promulgated, even though it may become the subject of judicial review, the Board should ordinarily apply the law expressed in the rule as promulgated, unless a court order issued in the course of the review proceeding would preclude that action. While unusual circumstances may require departure from this approach, adherence to existing law during rulemaking followed by prompt implementation of any newly-adopted rules is consistent both with the concept of prospective policymaking through the consideration and promulgation of rules and with the responsibility of the Board to provide ongoing enforcement of the Act.

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[128] See, e.g., Shapiro, *supra* note 3 and Berg, *supra*, note 9.

[129] See *supra* note 20 and accompanying text.

[130] Communications Workers v. Beck, 487 U.S. 735 (1988) (limitations on the expenditures of dues and fees collected pursuant to union security provisions).

Adoption of any the measures recommended here will, however, only facilitate the use of rulemaking by the Board, not ensure that use. Short of legislatively-mandated rulemaking, the likelihood of further Board use of rulemaking ultimately depends upon the judgment that rulemaking contributes meaningfully to the effectuation of the purposes of the Act, as those purposes are understood by individual members. The health care unit rulemaking, and its aftermath, will provide critical data as that issue is pondered and, perhaps most importantly, will serve to move discussion from the abstract to the concrete.

## Report for Recommendation 91-6

# Administrative and Legal Aspects of Federal Supervision of Safety and Soundness of Government Sponsored Enterprises

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# A. Introduction

The federal government provides credit support to a variety of financial institutions today. Commercial banks, thrifts, and credit unions benefit from federal deposit insurance, and government sponsored enterprises benefit from an implicit guarantee of their obligations and mortgage-backed securities. All of these institutions are instrumentalities of the United States; they are privately owned and federal law endows them with public purposes.[1]

Because the federal government's credit backing removes much of the usual market discipline, effective government regulation is essential to help contain risk-taking by such financial institutions and help assure their long-term viability.[2] While there is a considerable and growing literature concerning supervision of safety and soundness of banks and thrift institutions, much less has been written about government sponsored enterprises.

This paper addresses issues, and particularly the administrative aspects, of federal supervision of government sponsored enterprises. The paper summarizes the institutional and administrative law framework for federal supervision of banks and thrift institutions today and examines how this framework might be applied to government sponsored enterprises as well. While the bank regulatory framework is directly relevant to federal oversight of safety and soundness of government sponsored enterprises, there are some

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[1] *See* Ronald C. Moe and Thomas H. Stanton, "Government Sponsored Enterprises as Federal Instrumentalities: Reconciling Private Management with Public Accountability," *Public Administrative Review*, Vol. 49, July/August 1989, pp. 321-329; and Thomas H. Stanton, *A State of Risk* (New York: HarperBusiness, 1991), pp. 205-207.

[2] These lessons have been derived from experiences with a variety of financial institutions whose borrowing is implicity or explicitly backed by the federal government. See e.g., Mark J. Flannery, "Deposit Insurance Creates a Need for Bank Regulation," Business Review, 17-27, (January/February 1982) Federal Reserve Bank of Philadelphia; Fischer Black, Merton H. Miller and Richard A. Posner, "An Approach to the Regulation of Bank Holding Companies" 51 *Journal of Business*, 379-412 (1978); Sherman J. Maisel, Ed., *Risk and Capital Adequacy in Commercial Banks*, especially Chapter 6 (1981); and Frederick T. Furlong and Michael C. Keeley, "Bank Capital Regulation and Asset Risk," *Economic Review*, Spring 1987, Federal Reserve Bank of San Francisco; see also Kevin E.Villani, "The Federal Forecast," *Secondary Mortgage Markets*, 26-33, Federal Home Loan Mortgage Corporation (Spring 1985); and Edward J. Kane, "Comment," *The Federal National Mortgage Association in a Changing Economic Environment*, (Symposium) 181-189, U.S. General Accounting Office (July 17, 1985).

attributes of some of the enterprises that may permit development of refined supervisory approaches that may improve protection of taxpayers while minimizing regulatory interference in the business activities of the institutions.

After describing the government sponsored enterprises today, Section I of this paper compares their institutional and legal characteristics with those of banks and thrift institutions. Section II examines the financial risks involved in enterprise lending and the need for the federal government to regulate safety and soundness to compensate for missing market discipline. Section III reviews the institutional and administrative elements of effective financial supervision. This introductory material provides the necessary background for the core of this paper. Section IV analyzes the administrative and procedural aspects of federal financial supervision and proposes adaptations appropriate to the particular characteristics of government sponsored enterprises. Section V surveys federal oversight of enterprise safety and soundness today, including the administrative difficulties of enforcing some enterprise capital requirements today. Section VI reviews the findings and recommendations of the 1990 and 1991 reports on government sponsored enterprises by the U.S. Treasury Department and U.S. General Accounting Office and the 1991 report by the Congressional Budget Office, and examines some of the regulatory and administrative issues involved. Section VII looks briefly at federal oversight of the programmatic mission of each enterprise and explores the issue of possible regulatory conflict between effective federal supervision of safety and soundness and executive branch oversight of public purposes. Section VIII concludes with some practical observations.

## B. The Government Sponsored Enterprises Today

### 1. Introduction

The federal government uses government sponsored enterprises to fund loans to borrowers, such as homebuyers, students, and farmers, considered otherwise not adequately served in the marketplace by the provision of credit on appropriate terms. Today there are eight government sponsored enterprises that fund almost a trillion dollars of loans to homebuyers, farmers, students, thrift institutions, the insolvent Federal Savings and Loan Insurance Corporation (FSLIC) and the Resolution Trust Corporation (RTC). The eight enterprises are the Farm Credit System (FCS),[3] the Federal National Mortgage Association (Fannie Mae),[4] the Federal Home Loan Mortgage Corporation (Freddie Mac),[5] the Student Loan Marketing Association (Sallie Mae),[6] the Fetderal Home Loan Bank System (FHLBS),[7] the Federal Agricultural Mortgage Corporation (FAMC),[8] the Financing Corporation (FICO),[9] and the Resolution Funding Corporation (REFCORP).[10]

Government sponsored enterprises have special characteristics, including a combination of private and governmental attributes, that have tended to confuse observers. On the one hand, enterprises share attributes with public institutions: they are established by Congress; they issue debt obligations with most of the characteristics of federal Treasury securities; they are governed by boards that usually include governmentally-appointed directors; they may borrow from the federal Treasury; their obligations are implicitly guaranteed by the federal government, creating potentially open-ended claims on federal funds; they are considered instrumentalities of the federal government with charters that preempt some state laws and taxes; and, because of their federal instrumentality status, they probably cannot go bankrupt under the Federal Bankruptcy Code.

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[3] 12 U.S.C. 2001-2279aa. The Federal Land Banks were established in 1916, the Federal Intermediate Credit Banks (FICBs) in 1923, and the Banks for Cooperatives (BCs) in 1933. 1987 legislation combined the FLBs and FICBs into Farm Credit Banks (FCBs). The FCBs and BCs, together with their cooperative associations, constitute the Farm Credit System.

[4] 12 U.S.C. 1716-1723d. Fannie Mae had its origins in the National Housing Act of 1934, Pub. L. No. 73-479, 48 Stat. 246, authorizing establishment of National Mortgage Associations. In 1938 the Reconstruction Finance Corporation established the Federal National Mortgage Association as a subsidiary. Fannie Mae's charter was codified in the Housing Act of 1954, Pub. L. No. 83-560, 68 Stat. 590. The Housing and Urban Development Act of 1968 Pub. L. No. 90-448, 82 Stat. 536, partitioned Fannie Mae into a privately financed secondary market institution, today's Fannie Mae, and a government agency called the Government National Mortgage Association, today's Ginnie Mae.

[5] 12 U.S.C. 1451-1459. Freddie Mac was established in 1970 by the Emergency Home Finance Act, Pub. L. No. 91-351, 84 Stat. 451 (1970).

[6] 20 U.S.C. 1087-2. Sallie Mae was established in 1972 by the Education Amendments of 1972, Pub. L. No. 92-318, 86 Stat. 265.

[7] 12 U.S.C. 1421-1449. The Federal Home Loan Banks were established in 1932 by the Federal Home Loan Bank Act, Chap..552, 47 Stat. 725 (1932).

[8] 12 U.S.C. 2279aa *et seq*. Farmer Mac was established by the Agricultural Credit Act of 1987, Pub. L. No. 100-233.

[9] 12 U.S.C. 1441. FICO was established by the Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987, Pub. L. No. 100-86.

[10] 12 U.S.C. 1441b. REFCORP was established by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73.

On the other hand, enterprises also possess many of the characteristics of private companies. They are privately owned; they sell stock to private persons and institutions; their employees are exempt from federal civil service and procurement laws; they are free to make a profit; and their operations do not depend upon regular federal appropriations.

The following definition is intended to resolve some of this confusion: A government sponsored enterprise is a privately owned, federally-chartered financial institution with nationwide scope and specialized lending powers that benefits from an implicit federal guarantee to enhance its ability to borrow money.[11] Enterprise growth can be quite rapid. Sallie Mae, for example, grew from $2.8 billion in assets in 1980 to $41.1 billion in 1990. Fannie Mae and Freddie Mac today are huge institutions. At yearend 1990, for example, Fannie Mae had $133 billion of assets plus $300 billion in guaranteed mortgage-backed securities, and Freddie Mac had $41 billion of assets plus $316 billion in guaranteed securities. This makes them larger than the largest U.S. banking institutions in their total volume of lending activity (assets plus guarantees). Today, Fannie Mae and Freddie Mac fund roughly one out of four residential mortgages in the United States. Fannie Mae grew by $80.4 billion in 1990 alone.

Table 1 shows a slightly different measure of enterprise growth, the volume of enterprise securities outstanding over the years. The Congressional Budget Office calculates that enterprise securities have gone from $38.9 billion outstanding in 1970 to $176.9 billion in 1980 and $980.1 billion in 1990. That 25-fold growth over 20 years includes creation of new enterprises, notably Freddie Mac in 1970 and Sallie Mae in 1972.

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[11] This is essentially the definition adopted in Ronald C. Moe and Thomas H. Stanton, "Government Sponsored Enterprises as Federal Instrumentalities Reconciling Private Management with Public Accountability," *Public Administration Review*, Vol. 49, July/August 1989, pp. 321-329.

## Table 1

### *GSE Securities Outstanding at the End of the Year (in billions of dollars)*

| | 1970 | 1975 | 1980 | 1985 | 1986 | 1987 | 1988 | 1989 | 1990 |
|---|---|---|---|---|---|---|---|---|---|
| Farm Credit System | | | | | | | | | |
| Banks for Cooperatives | 1.9 | 3.8 | 8.6 | 9.4 | 8.6 | 9.9 | 11.9 | 12.6 | 13.3 |
| Farm Credit Banks[a] | 11.4 | 24.3 | 51.8 | 60.6 | 54.3 | 45.6 | 41.1 | 42.4 | 41.9 |
| Federal Home Loan Bank System | 10.5 | 16.4 | 37.3 | 75.6 | 89.6 | 116.4 | 136.5 | 136.8 | 117.9 |
| Freddie Mac | | | | | | | | | |
| Debt | b | 5.6 | 4.7 | 11.8 | 13.4 | 17.5 | 24.8 | 24.1 | 28.4 |
| Mortgage-Backed Securities | b | 1.6 | 17.0 | 100.5 | 169.2 | 212.6 | 226.4 | 272.9 | 316.4 |
| Fannie Mae | | | | | | | | | |
| Debt | 15.2 | 30.0 | 54.9 | 94.0 | 93.6 | 97.1 | 105.5 | 116.1 | 123.4 |
| Mortgage-Backed Securities | b | b | b | 55.0 | 97.2 | 140.0 | 178.3 | 228.2 | 299.8 |
| Sallie Mae | b | 0.3 | 2.7 | 13.4 | 17.1 | 21.4 | 27.0 | 33.6 | 39.0 |
| TOTAL | 38.9 | 82.0 | 176.9 | 420.3 | 542.9 | 660.5 | 751.4 | 866.7 | 980.1 |

SOURCE: Congressional Budget Office, *Controlling the Risks of Government-Sponsored Enterprises*, (April 1991) Table 3, p. 12.

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[a] Before 1987, composed of the Federal Intermediate Credit Banks and the Federal Land Banks.

[b] Not yet operating

A variety of reasons help explain this dramatic growth in enterprise activity. Enterprises serve sectors of the economy--housing, agriculture and education--with significant demand for credit. They are able to borrow virtually unlimited amounts of money in the federal agency credit market on favorable terms. They are exempt from state laws and taxes applicable to many competitors. As federal instrumentalities they are not subject to burdensome requirements such as state-doing business laws. They are also free from federal securities registration requirements and, indirectly, are permitted to avoid most state securities requirements.

Moreover, enterprises are exempted by federal law from all state and local taxes, except real property taxes. Some enterprises have additional tax benefits. The Federal Home Loan Banks, the Financing Corporation and REFCORP, Farmer Mac, and the Farm Credit Banks (but not the FCS Banks for Cooperatives) are exempt from federal income taxes, and federal law exempts investors in securities of Sallie Mae, Farmer Mac, the Farm Credit System, the Federal Home Loan Banks, the Financing Corporation and REFCORP from state and local taxes on their interest income. These benefits increase the ability of a government sponsored enterprise to operate without many of the constraints and costs facing their private competitors.

Except for limitations imposed by Congress or a regulator, there seem to be few constraints to prevent enterprises from issuing ever-increasing amounts of debt and other securities. On the lending side, enterprises seem limited only by the size of their statutorily permitted markets and by competition from other institutions with governmental support. By FY 1990, outstanding enterprise securities amounted to $855 billion, compared to $726 billion in federally-backed deposits in savings and loan institutions. Table 1 shows how several of the enterprises--Fannie Mae, Freddie Mac, and Sallie Mae--have more than doubled in size in 5 years. The rate of enterprise growth is likely to present a serious policy issue for Congress.

## 2. The Implicit Federal Guarantee of Enterprise Obligations

As perhaps their most valuable financial advantage, enterprises benefit from implicit federal government backing for their corporate guarantees and obligations. This federal credit support permits enterprises to obtain virtually unlimited funds at very low cost, close to the rates at which the U.S. Treasury itself borrows money. The federal government provides this credit support through an ingenious device. Even though enterprises are privatelyowned and managed, federal law gives their obligations the financial attributes of Treasury obligations; similarly, the law provides their guaranteed securities the attributes of federally guaranteed securities. Like U.S. Treasury obligations, enterprise obligations, with some variations, have the following characteristics:

- For most enterprises, they may be issued only upon approval of the Secretary of the Treasury, who also approves terms such as interest rate and maturities;

- They are exempt from regulation by the SEC except to the extent that U.S. government securities are regulated;

- They are lawful investments for federally supervised institutions, including banks, thrift institutions, and credit unions and have favorable government-type status in the portfolios of these institutions. (For example, shorter-term enterprise obligations may be used to meet liquidity requirements of thrift institutions, and national banks may invest and deal in enterprise obligations without limit);

- They are lawful investments for federal fiduciary, trust and public funds;

- They are issuable and payable through the facilities of the Federal Reserve Banks;

- They are eligible collateral for Federal Reserve advances and discounts and are eligible to be bought and sold in Federal Reserve open market operations; and

- For most enterprises, they are exempt from state and local taxation.

The one big difference between enterprise securities and U.S. Treasury obligations is the nature of the issuer; enterprises are privately owned and are not part of the federal government. The enterprises have additional characteristics that strengthen the perception of governmental backing:

- They are federally chartered instrumentalities of the United States;

- They usually have explicit authority to borrow from the U.S. Treasury; and

- They are controlled by boards that--for most enterprises--include some governmentally-appointed directors.

Taken together, these attributes amount to an implicit federal guarantee that enterprises will not be allowed to default on their obligations. The federal government makes a strong statement to investors by conferring on enterprise securities the same preferred investment status as U.S. Treasury obligations. The exemption from the usual SEC registration laws removes investor protections considered important for usual corporate securities. The exemption from investment restrictions on banks and thrift institutions is otherwise limited to federally-backed securities. Investors perceive that the government would not permit these exemptions from basic investor protection unless enterprise securities were extremely safe.

This means that investors look primarily to the implicit federal backing as a guarantee of an enterprise's creditworthiness, rather than looking at its balance sheet. Thus, while borrowing costs did rise somewhat for the Farm Credit System, even after the enterprise recorded $4.6 billion of losses in 1985 and 1986, Farm Credit System obligations remained eligible investments for AAA-rated debt.

Over time, the market can become even more confident about the government's likelihood of backing obligations of government sponsored enterprises. As the value of outstanding enterprise obligations increases, so does the inability of the federal government to intimate that it would not stand behind this debt.

When the Continental Illinois National Bank failed in 1984, for example, the federal government not only stood behind FDIC-insured deposits, but also protected uninsured bank creditors, and even creditors of the parent holding company. The Comptroller of the Currency told Congress of fears of a domestic and possibly an international financial crisis if all Continental creditors were not protected. The Comptroller of the Currency concluded that because of their size alone, the federal government cannot permit the failure of any of the nation's largest money center banks, many of which are significantly smaller than government sponsored enterprises. Continental Illinois was the nation's sixth largest bank. It had assets of $41 billion, and was smaller than were Fannie Mae, the Federal Home Loan Bank System, or the Farm Credit System.[12]

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[12] The federal government continues to fear precipitating financial calamity if it hesitates to protect all investors--with insured and uninsured accounts--in large insolvent institutions. Such institutions are thus said to be "too big to fail." See, e.g., U.S. Treasury Department, "Modernizing the Financial System: Recommendations for Safer, More Competitive Banks," February 1991, pp. III-29 to III-31.

In summary then, the federal backing of enterprise obligations may be implicit, but it is very real. As in the case of the Farm Credit System, taxpayers have literally billions of dollars at stake if an enterprise fails to meet its obligations.

## C. Overview of the Enterprises and Their Development

Enterprises have a long tradition as instruments of federal policy. The earliest enterprises were started with capital contributions from the federal government that were later repaid or forgiven when the government sold or gave all of its stock to private shareholders. The following discussion provides an overview of the origins and development of the eight enterprises.

### 1. The Farm Credit System

The oldest enterprise, the Farm Credit System (FCS), had its origins in 1916 when the federal government established the Federal Land Banks and affiliated cooperative associations to encourage the flow of credit for farm mortgage loans. The FCS was expanded in 1923 with creation of the Federal Intermediate Credit Banks (FICBs) and Production Credit Associations to make farm operating loans, and in 1933 with the Banks for Cooperatives, to lend to agricultural producer cooperatives. The FCS banks, either directly or through their affiliated associations, make loans and provide a variety of other financial services to their borrowers. The associations have assumed an increasing role in the FCS under recent provisions of the law. From the beginning, FCS institutions--banks and associations--have been structured as cooperatives owned and controlled by their borrowers.

### 2. The Federal Home Loan Bank System

The second oldest enterprise, the Federal Home Loan Bank System was established in 1932 to provide funds to the thrift industry that had been heavily damaged in the Great Depression. The Federal Home Loan Banks were authorized to make cash advances (i.e., loans secured by collateral provided by the borrower) to thrift institutions. The FHLBS is owned and controlled by thrift institutions (and a few other specialized housing lenders) under legislation requiring all thrifts to purchase minimum amounts of stock in the FHLB serving their geographic district.

Because of the Depression, thrifts found themselves faced with large-scale withdrawals of deposits. At the same time, deflation in real estate made it impossible to sell their portfolios of mortgages that those deposits had funded.

The FHLBS cash advance system permitted thrifts to use their mortgages as collateral and to borrow funds from the Federal Home Loan Banks.

Over time, the FHLBS advances became an inexpensive source of funds for many thrifts. For many years, from 1966 until the mid-1980s, federal law limited the interest rates thrifts paid on their deposits. FHLBS advances were especially valuable to substitute for lost deposits whenever market rates of interest rates rose above the regulatory ceiling and depositors closed their accounts to invest elsewhere such as in higher yielding money market accounts. Today, FHLBS advances provide a valuable source of funds for thrift institutions and a few commercial banks and credit unions engaged in residential mortgage lending. Large thrifts tend to use FHLBS advances much more than smaller thrifts; altogether, roughly half of the institutions that are members of the FHLBS also receive advances. Since 1982, thrifts have been permitted to use other marketable assets and not just mortgages as collateral for FHLBS advances. FHLBS member institutions may borrow routinely from the FHLBS and advances can have maturities up to 20 years.

## 3. Fannie Mae

In 1934, the Roosevelt Administration proposed creation of another set of enterprises, national mortgage associations, to provide a secondary market for residential mortgages. Under the original legislation, any incorporator willing to commit the necessary capital and to accept the benefits and limitations of the federal legislation, was authorized to obtain a federal charter for a national mortgage association. Largely because of opposition from the thrift industry, the benefits of a national mortgage association charter were quite limited. This compounded the general economic hesitancy prevalent after 1929, and no private incorporators ever sought a charter.

Instead, in 1938, the Reconstruction Finance Corporation, an arm of the federal government, chartered the National Mortgage Association of Washington, quickly renamed the Federal National Mortgage Association or FNMA, as a mortgage lending subsidiary. Fannie Mae was later transferred to the predecessor agency of the Department of Housing and Urban Development (HUD), and in 1968 was divided into a government agency, called the Government National Mortgage Association (Ginnie Mae) and a privately-owned Federal National Mortgage Association (Fannie Mae). Fannie Mae has an 18-member board of directors, 13 elected by their shareholders and 5 appointed by the President of the United States.

For decades Fannie Mae has served housing finance by purchasing and holding residential mortgages in portfolio. The Emergency Home Finance Act of 1970 permitted Fannie Mae to deal in conventional mortgages (i.e., those with private mortgage insurance), and not just in mortgages insured by the

Federal Housing Administration (FHA) or guaranteed by the Veterans Administration (VA). In 1981, after rising interest rates caused substantial losses from its portfolio lending business, Fannie Mae followed the example of Ginnie Mae and Freddie Mac and also began guaranteeing mortgage-backed securities as a means of funding home mortgages.

## 4. Freddie Mac

In 1970, the thrift industry persuaded Congress to create a second government sponsored enterprise to support home mortgages in the secondary market, called the Federal Home Loan Mortgage Corporation, or Freddie Mac. For many years, only thrift institutions were permitted to own Freddie Mac stock. The law was revised in 1988 to permit sale of Freddie Mac stock to the general public as well. Another recent change concerns Freddie Mac's corporate structure. From 1970 until recently Freddie Mac's Board of Directors consisted of the three federal officials that also constituted the Federal Home Loan Bank Board (FHLBB). In the 1989 legislation abolishing the FHLBB, Freddie Mac obtained a shareholder-controlled board of directors patterned on that of Fannie Mae.

From its inception, Freddie Mac chose a strategy of funding home mortgages by guaranteeing mortgage-backed securities and today its mortgage portfolio is a small part of its total lending activities. It remains to be seen whether the change in Freddie Mac's Board of Directors, and the 1988 change from thrift-shareholders to general investor-shareholders, will affect this lending strategy. In contrast to its earlier years, Freddie Mac now may face some shareholder pressure to maximize short-term returns, and possibly to increase its risk-taking and income from increased portfolio lending. Today Fannie Mae and Freddie Mac operate under similar charter legislation and provide secondary market service to the same kinds of residential lenders, including thrift institutions, mortgage bankers, and commercial banks.

## 5. Sallie Mae

The Congress created Sallie Mae in 1972 to enhance financial support for federally guaranteed student loans. At the time, guaranteed student loans seemed small, expensive to service, and generally unattractive for commercial banks and other private lenders. Sallie Mae was authorized to purchase student loans and to make advances (i.e., loans secured by student loans, to lenders). Over time, Sallie Mae has expanded its activities to include funding of student loans that are not federally guaranteed, and even other kinds of loans such as home equity loans (that some homeowners may use to borrow funds for their childrens' education). Sallie Mae is controlled by a board of directors consisting of seven members elected by financial institutions and seven by educational institutions, and seven appointed by the President of the United States. Sallie Mae has developed economies of scale, including sophisticated loan origination and servicing software for primary lenders. The government has now expanded kinds and amounts of student loans and has increased the subsidy paid to lenders in the guaranteed student loan program. These changes, and Sallie Mae's conspicuous success, have shown lenders that student loans can be a very profitable business, in contrast to their earlier reputation in the lending community.

## 6. Farmer Mac

The Federal Agricultural Mortgage Corporation (Farmer Mac) was established in 1988 to provide a secondary market for agricultural loans, essentially serving much of the same market as the Farm Credit System. Farmer Mac will guarantee mortgage-backed securities (MBS) issued by private lenders, including farm credit institutions, and based on pools of agricultural mortgages with characteristics specified in the law. FCS institutions, commercial banks, insurance companies and other rural lenders will originate and service the loans in the MBS pools.

In 1990, Farmer Mac obtained an expansion of its charter authority. It is now authorized to act as a pooler of loans guaranteed by the Farmers Home Administration and to issue debt to fund a portfolio, and to securitize such loans.

Farmer Mac stock is owned by commercial rural lenders and FCS institutions. The Farmer Mac board consists of 15 members, 5 elected by FCS-shareholders and 5 by commercial lender-shareholders, and 5 appointed by the President of the United States. Control by shareholders that are customers of Farmer Mac means that Farmer Mac will be oriented to the needs of its lender-users rather than to investors seeking to maximize Farmer Mac's profits.

## 7. FICO and REFCORP

Two of the enterprises, FICO and REFCORP, are bail-out corporations for the federal funds insuring thrift institution deposits. Unlike the traditional enterprises that exist to make commercial loans largely expected to be repaid, these two institutions and the FCS Financial Assistance Corporation (which performs a similar function for the bail-out of the FCS institutions) were designed to be commercial failures from the day they began operations. FICO and REFCORP are limited to purchasing FSLIC and Resolution Trust Corporation (RTC) securities that are expected to have no market value. It would be cheaper if the U.S. Treasury simply borrowed funds with an explicit federal guarantee and saved perhaps half of a percentage point in interest compared to the cost of the enterprise obligations.

The Office of Management and Budget, over the objections of the Congressional Budget Office, has described the funding corporations as technically "privately owned" so that they do not add immediately to the reported federal deficit. However, these corporations will add to the deficit over the next 30 years when the debtholders make good on the federal guarantee and turn to the federal government for payment of interest that the two corporations cannot pay by themselves. These institutions were created simply to defer the impact on the federal budget of paying to recapitalize failed financial institutions in a more straightforward manner. When pushed to this extreme, the enterprise model loses its original public purpose and becomes simply an instrument to pass today's financial burdens on to our children and grandchildren. Because the two enterprises are subject to virtually complete government control in the conduct of their operations, and because an analysis of these two enterprises by the Congressional Budget Office and the U.S. General Accounting Office indicates that they are governmental rather than privately-owned entities,[13] FICO and REFCORP will be excluded from the analysis in this report.[14]

## D. Enterprises Compared to Banks and Thrift Institutions

It turns out that enterprises have many institutional and legal characteristics in common with other federally-backed financial institutions such as commercial banks and thrift institutions.

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[13] See, Thomas H. Stanton, "Budgetary Consequences of Using a Government Sponsored Enterprise to Provide Financial Assistance to the Federal Savings and Loan Insurance Corporation," Reprinted in Committee on the Budget, House of Representatives, *The Thrift Institution Crisis and its Potential Impact on the Federal Budget*, February 3, 1989; House of Representatives, Committee on Banking, Finance and Urban Affairs, Report No. 101-54, Part 7, *Supplemental Report*, "Congressional Budget Office - Cost Estimate," pp. 4-5 (Robert D. Reischauer, Director, Congressional Budget Office, June 7, 1989); and U.S. General Accounting Office, "Government Sponsored Enterprises and the Proposed Resolution Funding Corporation (REFCORP)," Statement of Charles A. Bowsher, Comptroller General of the United States, Before the House Ways and Means Committee, April 18, 1989.

[14] REFCORP and FICO are also properly excluded from this report because they present quite different safety and soundness concerns from the other enterprises because of government rather than private control over their decisions. Unlike the other enterprises, that have virtually open-ended access to federal credit and thereby raise issues of moral hazard, the dollar limits of REFCORP and FICO have been capped in their enabling legislation.

## 1. Public Purpose

Like commercial banks and thrifts with federal deposit insurance, enterprises are federal instrumentalities; they are privately owned and serve a public purpose. The public purpose of a federal instrumentality is defined by the statutory provisions of its enabling legislation. Thus, national banks were established "to provide a uniform and secure currency for the people, and to facilitate the operations of the Treasury of the United States." *Mercantile National Bank v. City of New York*, 121 U.S. 138, 154, 7 S.Ct. 826, 834 (1887).[15] Thrift institutions have a statutory public purpose of providing "for the deposit or investment of funds and for the extension of credit for homes and other goods and services." 12 U.S.C. 1464(a). A credit union is chartered "for the purpose of promoting thrifts among its members and creating a source of credit for provident or productive purposes[.]" 12 U.S.C. 1752(i). Finally, the public purpose of each government sponsored enterprise is contained in the relevant enabling legislation. A good summary of the public purposes of the major enterprises is provided by the U.S. General Accounting Office. As the GAO states, the federal government established government sponsored enterprises,

> "...because it wanted to ensure that reasonably priced credit was available for borrowers seeking to finance homes, agricultural businesses, and college educations. The GSEs were created to correct what were perceived as flaws in the credit markets."[16]

The charter acts of each of the enterprises specify their public purposes. In general terms, Fannie Mae and Freddie Mac provide a secondary market for residential mortgages, the FHLBS provides credit support and other services to thrift institutions, Sallie Mae provides a secondary market for student loans, the FCS provides credit to agricultural borrowers, and Farmer Mac provides a secondary market for agricultural mortgages and loans guaranteed by the Farmers Home Administration.

As James Murray, then Senior Vice President and General Counsel of Fannie Mae has explained:

> "The act of chartering a corporation by Congress creates no separate public purpose. FNMA is chartered much like the First Bank of the United States or the Federal Home Loan

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[15] Today commercial banks are seen as "special" intermediaries because of the way they provide a means to transform short-term funds into longer-term illiquid investments. See, e.g., U.S. Treasury, "Modernizing the Financial System," *op. cit.*, p. III-5.

> Mortgage Corporation. Chartering by the Congress relates only to the method by which the corporation begins its existence. National banks and savings and loan associations are similar creatures of the Congress, but they have been given their existence through a different form. Similarly, COMSAT, AMTRAK, and the National Corporation for Housing Partnerships--although they are chartered under state laws rather than directly chartered by the Congress--perform public functions delegated to them by the Congress."[17]

National banks, federally-chartered thrifts, and enterprises all operate under federal charters that preempt a variety of state laws and some taxes; all three types of financial institution use federal credit support in the form of insurance or a guarantee that helps to reduce the cost of funds.

## 2. Financial Characteristics

These institutions do vary widely in some characteristics: some money center banks and government sponsored enterprises are huge institutions, while others are small; thrifts, credit unions, government sponsored enterprises and some commercial banks are specialized lenders, confined by law or by their managers' business strategies to serving limited categories of borrowers and providing limited kinds of financial services, while others are much more diversified; some commercial banks and government sponsored enterprises serve national markets, while others serve limited geographic areas. On the other hand, all of these institutions show one fundamental characteristic: they benefit from federal credit support that greatly attenuates market discipline. Moreover, this federal credit support means that, unlike many other financial institutions, their financial failure can cause potentially immense losses to taxpayers.

Table 2 compares characteristics of government sponsored enterprises with those of commercial banks and thrifts with federally-insured deposits. Like banks and thrifts, government sponsored enterprises are privately owned and serve a public purpose. They are generally profit-oriented and controlled by their private shareholders. While enterprises and thrifts are specialized lenders, commercial banks tend not to be. Some enterprises, notably Fannie Mae, Freddie Mac, Sallie Mae, and Farmer Mac, and some banks, are

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[16] U.S. General Accounting Office, "Government-Sponsored Enterprises: The Government's Exposure to Risks," August 1990, p. 16.

[17] James E. Murray, "Fannie Mae: Perspectives on a Unique Institution." FNMA/FHLMC General Counsel Conference (Washington, DC: Federal National Mortgage Association, 1978), p. 11.

geographically diversified in their lending; by contrast, thrifts have tended to specialize in lending in particular localities or regions of the country.

## 3. Federal Supervision

Table 3 compares the nature of federal controls over government sponsored enterprises and commercial banks and thrift institutions with federally-insured deposits. All government sponsored enterprises and national banks and many thrift institutions are federally chartered; many other commercial banks and many thrift institutions are state rather than federally chartered. The federal government supervises safety and soundness of most enterprises, with the notable exception of Sallie Mae, and of all commercial banks and thrifts with federal deposit insurance. State-chartered banks and thrifts are also supervised by a state agency. The variety of kinds of banks, for example, means that one single regulator such as the Comptroller of the Currency may be responsible for supervising institutions ranging from small rural lenders to large money-center banks, and types of loans running the gamut from agricultural loans to home mortgages to commercial loans and student loans, as well as many others.

Like banks and thrifts, government sponsored enterprises are subject to control through federal oversight rather than direct federal management. They lack the close federal nexus that would subject the corporation to constitutional due process requirements.[18] Similarly, they are not subject to civil service and federal procurement requirements, the Administrative Procedure Act and Freedom of Information Act (FOIA),[19] or federal budget accountability and controls.

## 4. Publicly-Appointed Directors

One interesting difference between government sponsored enterprises and commercial banks and thrifts is that a number of enterprises have on their boards of directors a minority of publicly-appointed, rather than shareholder-elected members.

One-third of Sallie Mae's 21 directors and 5 of Fannie Mae's and Freddie Mac's 18 directors are appointed by the President of the United States. The

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[18] *See e.g.*, *Roberts v. Cameron-Brown Co.*, 556 F.2d 357 (5th Cir. 1977); ***Northrip v. FNMA***, 527 F.2d 23 (6th Cir. 1975).

[19] See e.g., *Rocap v. Indiek*, 539 F.2d 174 (DCCir. 1976). The 1989 thrift legislation removed the direct federal control over Freddie Mac that had been critical to the court's finding that Freddie Mac was subject to FOIA. See also, Federal Home Loan Mortgage Corporation, "Notice of Withdrawal of Prior Notice Regarding Providing Information Concerning Organization, Rules and Access to Records," 55 Fed. Reg. 24313 (June 15, 1990).

Federal Home Loan Banks similarly have a minority of so-called public interest "directors" appointed by the Federal Housing Finance Board. One-third of Farmer Mac's directors are appointed by the President and confirmed by the U.S. Senate.

While such appointed directors can add a complementary viewpoint, they are likely to add little if any public control over an enterprise. As a general rule, directors owe a fiduciary responsibility to their shareholders and the corporation. They are also responsible for assuring that the institution obeys the law. There exists no basis for distinguishing public or appointed directors from shareholder-elected outside directors in these respects. All directors, publicly appointed and shareholder-elected alike, are subject to personal liability for breaching their fiduciary and legal responsibilities.[20] Absent specific statutory requirements, public directors are accountable to shareholders and the corporation rather than to a public mandate except to the extent these duties overlap.[21]

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[20] See Note, "Personal Liability of Directors of Federal Government Corporations," 30 *Case Western Reserve Law Review*, pp. 733-779. One congressional committee has made explicit that fiduciary duty of Presidentially-appointed directors to the private shareholders of Farmer Mac: "There is to be no distinction between the . . . categories of directors in terms of their duties and responsibilities as corporate directors to the Mortgage Corporation and all stockholders." Senate Agriculture Committee, Report: Farm Credit Amendments of 1987, Report No. 100-230, p. 52 (1987). See also Herman Schwartz, "Governentally Appointed Directors of a Private Corporation - the Communications Satellite Act of 1962," 79 *Harvard Law Review* (1965), pp. 350-364.

[21] For this reason, the National Academy of Public Administration believes that publicly appointed members should not be included on the boards of government sponsored enterprises or other federally chartered private corporations. National Academy of Public Administration, *Report on Government Corporations*, 1981, p. 32.

Table 2

Characteristics of Government Sponsored Enterprises and Commercial Banks and Thrift Institutions with Federally-Insured Deposits

| Characteristic | Government Sponsored Enterprises | Commercial Banks | Thrifts |
|---|---|---|---|
| Nature of Federal Credit Backing | Implicit Guarantee | Deposit Insurance | Deposit Insurance |
| Public Purpose | Yes | Yes | Yes |
| Ownership | Private | Private | Private |
| Profit Orientation | Usually | Yes | Yes |
| Shareholder Control | Yes | Yes | Yes |
| Specialized Lender | Yes | No | Yes |

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| | | |
|---|---|---|
| Geographically | Some | Some |
| Usually | | |
| Diversified | Enterprises | Banks |
| Not | | |

Table 3

Nature of Federal Controls Over Government Sponsored Enterprises and Commercial Banks and Thrift Institutions with Federally-Insured Deposits

| Type of Control<br>Thrifts | Government Sponsored Enterprises | Commercial Banks |
|---|---|---|
| Some<br>Federal Charter<br>Thrifts | Yes | Some Banks |
| Federal Supervision<br>Yes* | Most Enterprises | Yes* |
| Federal Procurement Laws and Regulation<br>No | No | No |
| Administrative Procedure Act<br>No | No | No |
| Freedom of Information Act<br>No | No | No |

| | | |
|---|---|---|
| Constitutional Due Process Requirements<br>No | No | No |
| Federal Budget<br>Off-Budget | Off-Budget | Off-Budget |

* State-chartered banks and thrifts with federal deposit insurance are supervised by a state agency as well as by a federal agency.

As with banks and thrift institutions, government sponsored enterprises raise two kinds of issues for the federal government: (1) the need to assure their safety and soundness despite operation of a federal guarantee that tends to undercut market discipline, and (2) the need to specify the proper scope of their permitted lending and other financial activities. This report concentrates largely on the administrative aspects of the first issue, although Section VII, below addresses some aspects of the second.

# II. Supervision of Safety and Soundness of Government Sponsored Enterprises: An Analytic Framework

## A. The Risks Involved in Enterprise Lending

Financial institutions are subject to a variety of risks. Some of these are associated with lending activities generally and others relate to the specialized kinds of lending by a particular enterprise. Different analysts may categorize risks somewhat differently, and new forms of risk are recognized as markets change. Two kinds of risk involve more fundamental factors than the others: the institution's management, and its market.

- **Management Risk**: Management risk includes the problem that some enterprise managers may not be of the highest quality. While managers of most enterprises today appear to be of high quality, unforeseen problems can arise because of increasing financial pressures or through changes in control. Management risk may be the single most important factor in the performance of a financial institution.[22]

- **Market Risk**: Enterprises are specialized lenders, and this can create vulnerability if the particular sector they serve suffers economic adversity. The Farm Credit System, for example, was harmed by the decline in American agriculture in the early 1980s. Fannie Mae and Freddie Mac would be

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[22] See e.g., Office of the Comptroller of the Currency, "Bank Failure: An Evaluation of the Factors Contributing to the Failure of National Banks," (1988); Robert L. Clarke, Comptroller of the Currency, "Banking in Troubled Times: What Hurts? What Helps? June 20, 1988.

> affected if there were a general decline in housing prices and a consequent decline in credit quality of some mortgages.[23]

In addition to the kinds of risk that affect lenders generally, enterprises must deal with particular risks related to their specialized activities. Mortgage lenders, for example, face prepayment risk. A significant decline in interest rates can cause prepayment of a substantial part of the higher-yielding loan assets held by a portfolio lender such as Fannie Mae. The uncertainty of mortgage prepayment rates can also create risk for issuers of special kinds of mortgage-backed securities such as some multi-class collateralized mortgage obligations.

Financial institutions are also susceptible to other kinds of risk. These include:

- **Credit Risk**: Credit risk is the risk that a borrower will fail to make timely payments of principal and interest on a loan held or guaranteed by a government sponsored enterprise or other lender. Credit risk applies both to loans held in enterprise portfolios and to those in pools of guaranteed mortgage-backed securities. Because an enterprise guarantees timely payment of principal and/or interest to investors in its obligations and guaranteed mortgage-backed securities, it must make timely payments and then seek recourse from the borrower, servicer, originator, or insurer of a delinquent loan. If a borrower defaults on a loan, the enterprise must supervise the process of foreclosing on collateral or otherwise reducing its losses.

- **Interest Rate Risk**: Interest rate risk involves the risk of losses when interest rates change. If an institution is funding a portfolio of long-term loans with short-term borrowings, or vice versa, the institution can either profit or lose when there are changes in the so-called yield curve (i.e., the relationship between long- and short-term interest rates). This kind of interest rate risk affects an enterprise's portfolio lending, but not its guarantees of mortgage-backed securities.

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[23] See, for example, N. Gregory Mankiw and David N. Weil, Harvard University, "The Baby Boom, The Baby Bust, and the Housing Market," September 23, 1988 for a discomforting prediction about significant declines in real housing prices over the coming years. The problem for enterprises as specialized lenders is the way such external factors can suddenly affect their whole portfolios. Lenders with diversified portfolios are not as thoroughly vulnerable to these factors. For example, thrifts suffered much more than banks from the jump in interest rates after 1979.

A second kind of interest rate risk involves the effect on a lender's business when interest rates rise or decline significantly. For example, a drop in interest rates may persuade borrowers to refinance their mortgage loans, thereby reducing the yield on mortgage portfolios. A significant increase in interest rates may reduce the volume of new business as borrowers are discouraged from taking out new loans.

- **Operations Risk**: Operations risk includes the ability of a lender to manage its business effectively. Enterprises are multi-billion dollar institutions that often grow by billions of dollars a year in net new business. Sophisticated computer operations are required to assure that the lender manages the literally millions of transactions that may occur every month to process loan payments and distribute payments in turn to holders of guaranteed mortgage-backed securities and enterprise obligations. Another part of operations risk is the problem that has occurred for some institutions, for example the Continental Illinois National Bank,[24] when their portfolios contain assets of significantly different quality from what their management information systems lead them to believe.

For Sallie Mae and other guaranteed student loan lenders, servicing risk is an important part of operations risk. Increasing defaults on guaranteed student loans have led the U.S. Department of Education to withdraw its guarantee when the student loan holder has failed to exercise due diligence in dealing with delinquent loans and attempting to prevent defaults. This means that student loan holders must actively oversee the servicing of their portfolios to an even greater extent than those who deal in other kinds of loans.

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[24] James P. McCollom, *The Continental Affair: The Rise and Fall of the Continental Illinois Bank*, pp. 262-3 (1987).

## B. The Implicit Federal Guarantee and its Effects on Enterprise Risk Taking

While managers in fact may be prudent, it must be recognized that an incentive to take excessive risk is inherent in the implicit federal government backing that permits government sponsored enterprises to issue and guarantee billions of dollars of securities. Because the federal government guarantee removes much of the usual market discipline, effective government regulation of safety and soundness is essential to help constrain enterprise risk-taking and assure the institution's long-term viability.

Because of the government guarantee, investors will not care much about the creditworthiness of an enterprise or the low quality of loans it might make; instead, investors will largely look to the implicit government backing for their assurance.

For a normal corporation, without such federal backing, investor concern about creditworthiness provides an important marketplace constraint on risk-taking. First, shareholders have a long-term interest in protecting and enhancing their capital investment in the company. For an enterprise however, the financial stake of investors tends to be very low compared to the volume of enterprise activities. In 1990, for example, both Fannie Mae and Freddie Mac maintained shareholder capital amounting to less than 1 percent of their assets and mortgage-backed securities outstanding.

Shareholders of a government sponsored enterprise can increase their returns by increasing risks and can leverage these benefits by greatly increasing the ratio of outstanding debt to shareholder equity. The federal government may receive no compensation (or even additional service to a public purpose) for bearing much of the extra risk from such enterprise activities, but has potentially unlimited liability if an enterprise fails.

It should be emphasized that enterprise managers, and managers of other financial institutions with federal backing, may in fact develop prudent business policies. However, the implicit federal guarantee does provide considerable incentive to seek extra returns by taking excessive risks. Heads, the corporation and its shareholders win; tails, the U.S. taxpayer is called upon to pay for the big mistakes. There is ample room within enterprise charter acts for managers to take risks if they were so inclined.[25]

Market discipline normally also comes from investors other than shareholders. Without the federal government's backing, a corporation is subject to considerable restraint when it issues debt obligations or guarantees securities. For the usual company, debtholders and purchasers of guaranteed securities will limit the degree of risk by demanding increasing returns for themselves as shareholders increase risk and attempt to increase leverage. Before investors rely upon the corporation's obligation or guarantee, they require assurances about the company's financial backing. Investors check not only the balance sheets of the corporation providing the obligation or guarantee, but also the credit quality of the assets standing behind the obligation or guarantee. Before purchasing unsecured debt obligations of a private corporation, investors require assurances about the corporation's balance sheet, including credit quality of assets it holds, the corporation's debt-to-equity ratio, and the corporation's general creditworthiness.

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[25] Besides the traditional kinds of credit and interest rate risk on loan portfolios, enterprises authorized to issue MBSs can segment these securities into higher- and lower-risk parts. See, e.g., Vartanig G. Vartan, "A Double Whammy of Volatility," *New York Times*, May 11, 1987, p. D10.

Similarly, before purchasing loan-backed securities issued or guaranteed by a private corporation, investors require assurances about the credit quality of the underlying loans, the credit quality of the loan pools, and the particular safeguards to assure that, in case of default, investors have sole recourse to the mortgage assets.

However, investors in enterprise securities are unlikely to provide such market discipline because the enterprise relies on the federal government's backing to sell its obligations and guarantee. Investors in enterprise securities are spared the need for much examination of the creditworthiness of the corporation, its assets, or asset pools or the quality of the corporation's management. Instead, they can be expected to rely largely upon the implicit federal backing upon which the obligations and guarantees will be based.[26]

This reliance upon the federal government rather than upon the enterprise's creditworthiness and the asset quality of guaranteed securities means that an enterprise can take much greater risks than could a private company in its line of business. An enterprise would have an extensive market for its debt obligations and guarantees even if, for example, it were undercapitalized and did not adequately police the credit quality of assets it bought or securities it guaranteed.

These concerns are not merely hypothetical. The banks of the Farm Credit System adopted an average-cost pricing policy for loans that permitted FCS institutions to use long-term debt to fund variable rate loans on the basis of FCS average debt funding costs. As interest rates rose during the 1970s, new debt tended to be priced somewhat higher than the average price of outstanding debt. Through the pricing of loans off of the average rather than the new debt costs, Farm Credit System institutions could offer borrowers lower priced loans than were available from competing lenders. By 1981, FCS banks were pricing their real estate loans almost 5 percentage points below the rates of their commercial competitors.

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[26] See e.g., Standard & Poor's Corporation, "'AAA Investments' Implied U.S. Support," *Credit Week*, pp. 19-20 (November 28, 1988).

This policy provided immediate rewards to FCS managers and their borrowers/shareholders. Managers were rewarded by increasing market share and were able to construct lavish new office buildings, hire staff, and generally expand the organization. FCS shareholders, unlike shareholders in corporate institutions, received their benefits largely in the form of lower loan rates, rather than from stock dividends, thus giving them an incentive to take out a greater than optimal volume of loans from FCS banks.

As the agricultural economy went into depression, loan delinquencies and defaults rose significantly. Then interest rates came down, and average cost pricing became impossible to sustain. The high volume of outstanding long-term debt issued by the FCS at times of high interest rates soon reflected itself in higher rates for borrowers, driving creditworthy borrowers to refinance their loans and take their business away from the FCS and to competing lenders.

Starting in 1985, the FCS began reporting huge annual losses, and the Governor of the Farm Credit Administration announced that the Farm Credit System required a massive infusion of federal funds within 18-24 months to remain in business. Even after this announcement, the implicit federal guarantee was perceived as being so strong that FCS could continue selling its debt less expensively than most private corporations. The Congress has already taken steps to pay for FCS losses resulting directly from excessive FCS risk-taking that, initially at least, provided substantial benefits to FCS managers and shareholders.

Fannie Mae underwent a similar experience, but fortunately with a happier ending. In the 1970s when short-term interest rates were less expensive than long-term rates, Fannie Mae was able to purchase billions of dollars of long-term mortgages and fund them with short-term debt. Because short-term debt was less expensive than long-term debt, at least for the moment, shareholders received immediate returns, above the normal returns that could be expected if funding had been done on a more matched maturity basis. This funding system was only possible because of the implicit government guarantee, that allayed concerns of Fannie Mae's debtholders about the extra risk involved. Without the implicit guarantee, these debtholders would have become increasingly unwilling to lend money inexpensively to Fannie Mae because of the growing interest rate risk in its operations.

Starting in 1979, short-term borrowing costs rose dramatically relative to long-term rates. Fannie Mae's debt costs soon exceeded returns on its portfolio of long-term mortgages bearing relatively low interest rates. By 1981, Fannie Mae had a market-value negative net worth of $10.8 billion. Fortunately, with energetic new management strategies and declining interest rates, Fannie Mae avoided the fate of the Farm Credit System. Again, while the federal government reaped few of the benefits from Fannie Mae's risky funding strategy, it stood to lose if that led to failure.

It is easy enough for an ordinary company to fail in the marketplace. Without marketplace discipline fully imposed through higher costs and an ultimate limit on the ability to sell debt obligations and other securities, government sponsored enterprises are at risk in this regard. The government guarantee dampens market signals, permitting even enterprises with poor balance sheets to continue selling obligations and guarantees at favorable interest rates.

For both the Farm Credit System and Fannie Mae, the enterprise consistently recorded substantial profits in the years before the potential risk exposure turned into actual corporate losses. If a high-risk strategy for such an enterprise is successful, benefits go primarily to the shareholders. If the high-risk strategy fails, the federal government is under virtually irresistible pressure to make good on its guarantee. The failure of hundreds of thrifts with federally insured deposits provides perhaps the most stark example of the way federal backing undermines usual market discipline that otherwise could limit losses when an institution falters or fails.

## C. Regulation of Safety and Soundness to Compensate For Missing Market Discipline

Because the federal government's guarantee removes much of the usual market discipline, effective government regulation is essential to help contain risk-taking and help assure long-term viability of enterprises and other institutions with federal backing.

Regulation is not an assured solution for problems that can arise when the government's implicit guarantee distorts normal market incentives. As can be seen in the regulatory history of the Farm Credit System or of thrift institutions governed by the Federal Home Loan Bank Board, regulators are often located in the same political and psychological environment as the institutions they regulate.

In particular, the Congress may be sensitive to constituencies interested in increasing rather than reducing the federal government's risk exposure. For example, even as the Farm Credit System Banks struggled to keep their portfolios above water, desperate farm borrowers were able to persuade members of Congress to pressure Farm Credit Banks to be lenient in handling delinquent loans. Similarly, the Federal Home Loan Bank Board came under considerable pressure to refrain from promptly closing thrift institutions with negative net worth that threatened to accelerate the federal government's risk exposure.

There is another problem with regulation. Regulators have not been very successful in detecting high risk problems in time. Regulators tend to be attuned to forms of risk which caused problems in the past rather than today's emerging problems.[27] Indeed, management has an incentive to shift risk away from regulated and into unregulated areas. Failure of the Continental Illinois National Bank provided a large example of the fact that regulation is not complete protection against risk exposure of the federal government.[28] Failure of hundreds of thrift institutions provides a sobering lesson about the potential costs of letting a regulator be dominated by the regulated institutions. Nevertheless, even with the emergence of possible new tools such as risk-related federal insurance premiums[29], prudent supervision of government sponsored enterprises is a necessary substitute for the market discipline that is lacking.

In their seminal article, Black, Miller and Posner argue that when the government acts as a guarantor, government regulation is called for. The government should try to control unnecessary risk-taking just as a private guarantor imposes control upon firms whose obligations it guarantees and the private lender oversees the creditworthiness of borrowers. "[E]fficient government regulation of banking would resemble the measures adopted by a private lender in a comparable position and...deviations from the private model are prima facie questionable."[30]

A private lender is concerned about capital and leverage of the borrower and about the borrower's general management ability. The lender will require disclosure of material events and may even insist on direct supervision of the borrower's business. The lender does not try to substitute for the borrower's judgment in general business decisions, but tries to prevent action such as increasing riskiness of business activities that benefit the borrower at the lender's expense.

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[27] See e.g., Joseph F. Sinkey, Jr., "Regulatory Attitudes Towards Risk," in Richard C. Aspinwall and Robert A. Eisenbeis, Eds. *Handbook for Banking Strategy* (1985), pp. 347-380.

[28] See, e.g., *Staff Report of the Subcommittee on Financial Institutions, Supervision, Regulation and Insurance of the House Committee on Banking, Finance and Urban Affairs, Continental Illinois Bank: Report of an Inquiry into its Federal Supervision and Assistance*, 98th Cong., 2d Sess., (1984).

[29] See e.g., Robert Van Order, "User Fees and Mortgage Markets," *Housing Finance Review*, Vol. 6, pp. 93-114 (1987) at p. 94. Farm Credit System institutions have begun to pay risk-related premiums into a fund of the FCS Insurance Corporation. See 12 U.S.C. 2277a. It is not at all clear that the level of insurance premium is sufficient to cover the actuarial risk of loss to the fund.

[30] Fischer Black, Merton H. Miller, and Richard A. Posner, "An Approach to the Regulation of Bank-Holding Companies," *Journal of Business*, Vol. 51, No. 3 (1978), p. 382.

Federal supervision of banks and thrift institutions today fits well within the analytic framework of Black, Miller and Posner. The expensive lessions of the financial regulatory failures of the 1980s have resulted in significant institutional and administrative improvements, especially with respect to regulation of thrift institutions.[31]

# III. The Elements of Effective Supervision of Safety and Soundness

## A. The Institutional and Administrative Framework

The elements of effective supervision of safety and soundness can be summarized as follows:

> (1) The regulator must be institutionally capable of overseeing safety and soundness of large institutions involving huge numbers of often complex transactions.
>
> (2) The regulator must be motivated to assure safety and soundness, and must not have conflicting missions that could impede that motivation.
>
> (3) The regulator needs to have authority to (a) require appropriate financial accounting, reports, and disclosures, (b) examine financial conditions, (c) set and enforce capital requirements, (d) set and enforce restrictions on excessive risk-taking, and (e) deal with a faltering or failing enterprise.
>
> (4) The discretion of the regulator should be confined to safety and soundness issues, and structured to assure that the regulatory authority is properly used.

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[31] A variety of changes to bank regulation are proposed by the U.S. Treasury Department, *Modernizing the Financial Aystem: Recommendations for Safer, More Competitive Banks*, February 1991. See especially Chapters IX, "Risk-Management Techniques," and X, "Prompt Corrective Action."

In analyzing these elements, federal supervision of banks and thrift institutions provides a useful pattern. First, as the experience of the bank and thrift regulators has shown, institutional capability can be enhanced by freeing the agency from federal budget constraints, personnel ceilings, and civil service salary levels. It is difficult if not impossible to staff a financial regulator within today's usual governmental constraints on staffing and salaries. Assessing the regulated government sponsored enterprises for the costs of financial supervision provides a means for meeting staffing needs. As discussed below, this is already part of the enabling legislation of two enterprise regulators, the Farm Credit Administration and the Federal Housing Finance Board.

Second, the regulation of enterprise safety and soundness must not be impeded by conflicting responsibility for promoting the programmatic mission of an enterprise. It was not helpful to give but one example for thrifts to be regulated by a Federal Home Loan Bank Board that was statutorily required to promote the industry that it was supposed to supervise.[32] The Treasury and GAO reports provide ample documentation for this caveat. The legislative process provides the appropriate means to make tradeoffs between the public purposes of each enterprise and safety and its soundness. These tradeoffs, while properly informed by analysis provided by executive agencies, are political rather than administrative in nature. As is discussed in Section VII, below, they involve issues of political benefits that are simply too value-laden for an administrative agency to address effectively on a decision-by-decision basis. Once there is legislated agreement on any tradeoffs to be made against the need for safety and soundness, then an administrative agency should implement the statute to its full extent.

Third, many of the administrative issues concerning financial supervision have already been addressed in the course of regulating safety and soundness of thrifts and banks. The economic consequences of federal deposit insurance are comparable in essential respects to those of the federal backing of enterprise obligations and mortgage-backed securities. To the extent that the bank regulatory model is appropriately adapted, it may be possible to avoid having to repeat some of the difficulties that faced federal bank regulators in earlier years. The Congress recognized this parallel with federal bank regulation in the 1980s when it restructured the Farm Credit Administration (FCA) and provided the FCA the institutional capabilities, supervisory authority, and enforcement powers of bank regulatory agencies.[33] The U.S.

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[32] See 12 U.S.C. 1465 (Repealed, 1989).

[33] See, e.g., Committee on Agriculture, U.S. House of Representatives, "Farm Credit Act Amendments of 1985, Report [To Accompany H.R. 3792]", Report 99-425, December 6, 1985.

General Accounting Office similarly views bank supervision as a useful model.[34]

This said, it is also true that some modifications in the bank supervisory model are appropriate, to the extent that government sponsored enterprises differ from banks. One difference is in numbers of institutions; there are only a few government sponsored enterprises compared to the thousands of banks with federally-insured deposits. Also, many of the enterprises tend to rely on large volumes of repetitive transactions involving standardized kinds of loans, instead of holding portfolios of many kinds of loans with unique attributes. To the extent that this is the case, the government may be able to provide some regulatory guidelines in advance rather than addressing safety and soundness questions largely on an ad hoc basis through the examination process. Finally, some enterprises have developed sophisticated financial models for credit and interest rate risk that may permit use of more refined supervisory techniques than are available for more diversified financial institutions.

These special attributes mean that the government can customize certain regulatory requirements without creating difficulties that might occur if enterprises were more numerous or diversified in their lending or if appropriate financial models could not be generated. On the other hand, there is a danger in customizing too much. The government must set and enforce objective standards and apply these even against institutions whose officers and directors are well-known and well-regarded in Washington. Once the government stops applying objective standards within a clear conceptual framework, it will find itself on a slippery slope where each regulatory action tends to be seen in personal terms rather than as an institutional requirement that necessarily accompanies the government's guarantee of hundreds of billions of dollars of enterprise obligations.

Aside from the limited numbers of government sponsored enterprises, the undiversified lending and large size of many, and the availability of financial models to assess credit and interest rate risk, they seem analytically quite similar to banks and thrifts. In the confines of their charters, they are permitted to take excessive risks, by dealing in derivative mortgage-backed securities, for example.[35] Management information and control systems can also involve significant risks. Well-run institutions may be able to manage such risks and protect shareholders and taxpayers. As the guarantor of enterprise obligations and mortgage-backed securities, the government must be sure;[36] bank-type disclosure requirements and examination seem to be useful (if not completely effective) ways to find out if an institution is taking excessive risk. The government must also be empowered to intervene to protect its financial interests if that becomes necessary.[37]

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[34] "GAO compared the monitoring and capital regulatory structure used for banks with that used for government-sponsored enterprises because both groups present similar concerns to the government. In both situations, the government is interested in the financial firm's viability in part because the government may suffer financial losses from large-scale failure. In addition, federal ties can promote unsafe risk-taking on the part of banks, just as they can with government-sponsored enterprises."

U.S. General Accounting Office, *Government Sponsored Enterprises: The Government's Exposure to Risks*, August 1990, p. 4. See also Congressional Budget Office, *Controlling the Risks of Government Sponsored Enterprises*, April 1991, p. xix.

Section IV below, spells out ways that particular attributes of some enterprises can be used to fashion some improvements in the traditional bank-regulatory structure.

## B. Institutional Capability

Institutional capacity involves the ability and incentive of a regulator to intervene to the extent appropriate to address safety and soundness concerns. Most importantly, the regulator must have a clear and unassailable mandate to protect the financial interests of the govenment, even when these are adverse to those of the regulated institution and its shareholders.

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[35] See e.g., Ted Sandborn, "Stripped MBSs: They're No Myth," *Freddie Mac Reports . . .*, p. 5, August 1989 ("But investors should proceed with caution. Strips are more volatile than other MBSs, and they have a relatively short performance history. Other unexpected events, such as sudden rate drops or an inverted yield curve can lead to undesirable consequences if the strips are not properly matched.")

[36] See e.g., Professor Mark J. Flannery, "Judging Freddie Mac's Capital Adequacy," printed in *Roundtable Hearing on the Safety and Soundness of Fannie Mae and Freddie Mac*, Subcommittee on Housing and Urban Affairs, Senate Committee on Banking, Housing, and Urban Affairs, February 7, 1990, pp. 258-266:

> "Though the firm's charter confines it to a relatively limited set of activities, there is ample room within that charter's provisions to increase the business risk undertaken. In this regard, I believe that the most appropriate policy response is carefully *monitoring* Freddie Mac's performance and management decisions." (p. 264; emphasis in the original).

[37] The Congress has recognized that a federal regulator may even have to intervene in management-type decisions if this becomes necessary. The legislative history of both Fannie Mae and Freddie Mac, for example, specifies that "it is the intent of the committee that the regulatory powers of the Secretary will not extend to [Fannie Mae's or Freddie Mac's] internal affairs, such as personnel, salary, and other usual corporate matters, except where the exercise of such powers is necessary to protect the financial interests of the Federal Government or as otherwise necessary to assure that the purposes of the [Fannie Mae or Freddie Mac Charter] Act are carried out."

Housing and Urban Development Act of 1968, House Report (Banking and Currency Committee) No. 1585, June 25, 1968 (to accompany H.R. 17989), and Financial Institutions Reform, Recovery and Enforcement Act of 1989, "Supplemental Report of the House Committee on Banking, Finance and Urban Affairs, Report 101-54, Part 3, p. 2, June 1, 1989.

The regulator must also have the requisite ability to (1) obtain relevant information, (2) make appropriate judgments, (3) intervene appropriately, and (4) defend itself in litigation if necessary. This involves administrative authority, discussed below, and also the requisite institutional capability. The federal regulator must possess staff that are capable of making sophisticated financial and legal assessments and judgments, and must possess such staff in sufficient numbers.

The Federal Home Loan Bank Board, for example, suffered from lack of institutional capacity during much of the 1980s. As one senior FHLBB official put it, "We had amateurs chasing professionals. Our examiners didn't understand the implications of many sophisticated financial transactions until they turned into losses."[38] Today, the Office of Thrift Supervision, successor to the Federal Home Loan Bank Board, benefits from a substantial increase in the number of examiners and their qualifications undertaken by the FHLBB in the last years of its existence.[39]

Both the OTS and the federal bank regulators obtain the requisite institutional capacity through provisions in the law that exempt them from the budget, staffing, and salary ceilings that badly constrain many federal agencies. The FDIC, for example, derives its funds from assessments on the regulated institutions, and thereby avoids the federal appropriations process. The FDIC also sets its own staffing ceilings, and again avoids the federal budget process. Finally, the FDIC sets its own salary schedules, in general conformity with the salary levels of other federal bank regulators.

Two of the GSE regulators, the FHFB and FCA, similarly fund themselves through assessments on the financial institutions they regulate, and also set their own salary ceilings, consistent with those of the federal bank regulators. The FHFB sets its own staffing ceilings, but the FCA is limited by a provision of federal appropriations law. The FHFB and FCA are also free from controls by the Office of Management and Budget (OMB).

By contrast, HUD has none of these capabilities. HUD depends on federal appropriations, is subject to OMB controls and staffing ceilings, and is limited to civil service salary schedules. Table 4, at page 660 below, summarizes these elements of institutional capability for each regulator.

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[38] Senior FHLBB official, personal communication to the author (May 31, 1989).

[39] From June 1985 to June 1988, the FHLBB almost doubled its examination and supervisory staff, from 1,063 to 2,068, and also greatly improved the education and training of those examiners. Statement of M. Danny Wall, Chairman, Federal Home Loan Bank Board, Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, March 9, 1989, p. 20 (Mimeograph text).

A word of caution is merited about the use of statutory exemptions from usual government agency restrictions on budget, staffing levels and salaries. The superior approach would be to create special salary levels within the civil service for officials with exceptional financial expertise, and to fund and staff the financial regulators through the usual budget and appropriations processes. Thrift institutions and FCS institutions today complain about the burden of assessments to fund their regulators, and this can become a political issue.[40] Nevertheless, given clear evidence of the inability of traditional processes to provide adequate institutional capability for the FHLBB and for many other parts of the government today,[41] it is appropriate to fund and staff each enterprise regulator according to the precedent established by today's OTS and the federal bank regulators. Otherwise, the federal government will remain without the capability to monitor the use or misuse of the funds raised by some $1 trillion in federally backed enterprise securities.

## C. Statutory Mandate

The safety and soundness regulator has a task that is not always popular. To be effective it may have to intervene to prevent excessive risk-taking.[42] Tensions can become especially great when an institution begins to falter.

The Treasury Department urged in 1991 testimony, "...It is vital that any GSE [government sponsored enterprise] regulator be given the necessary support, both political and material, to function effectively." Indeed, as the Treasury noted,

> "The problem of avoiding capture appears to be particularly acute in the case of regulation of GSEs. The principal GSEs are few in number; they have highly qualified staffs; they have strong support for their programs from special interest groups; and they have significant resources with which to

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[40] Also, if enterprises were to decline in size, the regulators' assessment base would also decline, possibly forcing cuts in supervisory staff at a time when more intensive oversight might be needed.

[41] See, e.g., Charles A. Bowsher, Comptroller General of the United States, "An Emerging Crisis: The Disinvestment of Government," The James E. Webb Lecture, National Academy of Public Administration, Washington, DC, December 2, 1988.

[42] To borrow the felicitous comment of William McChesney Martin from another context, the regulator may be required to take away the punch bowl just when the party gets going. William Greider, *Secrets of the Temple*, (New York: Simon and Schuster, 1987) p. 328.

> influence political outcomes. A weak financial regulator would find GSE political power overwhelming and even the most powerful and respected Government agencies would find regulating such entities a challenge."[43]

To act effectively requires that the regulator have a clear mandate to act to protect taxpayers against excessive risk of financial loss. To avoid unnecessary controversy at a time of urgency, the mandate should include appropriate statutory authority and legislative direction. Again, the bank regulatory model lends itself to supervision of enterprise safety and soundness; those statutory provisions have been tested politically as well as financially and in litigation.

The importance of a mandate to act is seen in the experiences of HUD and the Farm Credit Administration in the 1970s. Warning signs were present both before Fannie Mae faltered after 1979 and before the Farm Credit System failed in the mid-1980s. Yet, in both cases, the federal government lacked the mandate to heed these warnings and make considered decisions to deal with them. Instead, the warning signs seem simply to have dissipated without further deliberation.

Robert Elliott, HUD General Counsel and also a publicly appointed director of Fannie Mae, warned in 1976 of the dangers of "the money market risk (borrowing short, lending long) being taken with each net addition to assets and liabilities [by Fannie Mae.]"[44] It was precisely this borrowing short-lending long mismatch that caused Fannie Mae's financial difficulties a few years later.

In 1979, Donald E. Wilkinson, Governor of the Farm Credit Administration, prepared a strategic planning paper that considered possible "shocks" that might shake the Farm Credit System. He described the first possible shock, as follows:

> "A sudden decline in land values on local, regional, or national levels. A reduction in commodity prices causing a decline in farm income affecting all commodities couild affect land values across the country....Unusual speculative

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[43] Testimony of Robert R. Glauber, Under Secretary of The Treasury, Before the Senate Committee on Banking, Housing, and Urban Affairs, May 10, 1991, at p. 5 (Typewritten text).

[44] Robert R. Elliott, "Memorandum For: FNMA Board of Directors; The Corporation's Ten Percent Annual Target for Assets Growth," April 23, 1976, Reprinted in, "Secondary Market Operations of the Federal National Mortgage Association and the Federal Home Loan Mortgage Association," Hearings before the Senate Committee on Banking, Housing and Urban Affairs, December 9, 1976, pp. 395-411.

> demands might also affect prices in urban fringe areas. The System needs to be ready for events of this nature."[45]

It was precisely such a decline in commodity prices, farm income, and land values that brought down the Farm Credit System a few years later.

In the case of both enterprises, the warning signs were ignored. Neither HUD nor the FCA had the necessary mandate or the capability to act on the basis of such warnings, especially during times of growth and apparent profitability of each enterprise.

## D. Administrative Authority

Another important element of safety and soundness supervision is the extent of statutory authority conferred upon the regulatory agency. Federal financial supervision of banks and thrifts includes five major components:

- Financial disclosure and reporting requirements;
- Examination of financial condition and risk-taking;
- Effective capital requirements, including minimum capital standards and risk-based standards;
- Enforcement powers, including authority to disapprove high-risk activities; and
- Ability to deal with a faltering or failing institution.

Each of these is based on statutory provisions that have are being improved over the years to address shortcomings that become apparent from time to time.

The institutional framework for safety and soundness must address the fact that some of the enterprises are huge institutions. Fannie Mae and Freddie Mac hold or guarantee literally hundreds of billions of dollars of loans. If something goes wrong--even if the contingency is remote--it can go very wrong. The government has greatly concentrated its risks as two huge secondary mortgage market institutions become the mainstays of the residential mortgage market in place of hundreds of failed and failing thrift institutions.

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[45] Strategic Planning Commission--Federal Intermediate Credit Bank, "Agriculture's Environment. . . A Ten Year Look," pp. 95-101 (1979).

With so many eggs in only two baskets, it is important that the government be empowered to act promptly in the event of problems. Ground rules must be specified in advance, relating to authority to examine and audit, to set and enforce sanctions, and ultimately to intervene in management decisions if an institution begins to fail. Although the likelihood of outright failure may be remote, the potential cost of such failure is immense; the government must define the nature and extent of its authority beforehand, and also the nature of the events that would trigger use of such authority. Thus, bank-type regulatory authority, incorporating by reference the standards used by the federal bank regulators in taking such action, may be appropriate if only because it provides a defined set of powers and conditions.

## IV. Administrative and Procedural Aspects of Effective Supervision of Safety and Soundness

As a general rule, regulatory involvement in affairs of a financial institution should be roughly proportionate to the extent that the activities of that institution threaten financial loss to taxpayers. When the institution is well run and well capitalized, as indicated by reports and examinations, regulatory involvement should be minimal; as perceived safety and soundness problems arise, for example, because of increased enterprise risk-taking or unanticipated financial losses or a decline in capitalization below required standards, regulatory involvement should increase.[46] If an institution begins to falter or fail, the government must be empowered to act promptly to reorganize the institution or even to wind up its affairs. It is useful to analyze the individual elements of effective federal supervision and possible adaptations to the bank supervisory framework.

### A. Financial Disclosure and Reporting Requirements

#### 1. The Need for Information

Federal disclosure and reporting requirements must be tailored to the government's role as guarantor of the debtholders and its status as their surrogate with respect to financial risk. Equity holders have ample information about the risks and returns of stock ownership over the investor-owned enterprises. Wall Street investment firms churn out special and periodic reports reflecting even small changes in financial circumstances that could affect enterprise stockholders. However, equity holders tend to be interested in issues such as financial leverage (i.e., debt-to-equity ratios) and returns on equity that are not completely useful to debtholders or to the federal government as the debtholders' guarantor and surrogate. Thus, stock equity analysts have been notably unsuccessful in predicting bank failures. As one study point outs,

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[46] See Jonathan A. Neuberger, "How To Close Troubled Banks," FRBSF weekly letter, Federal Reserve Bank of San Francisco, December 7, 1990.

> "The most startling finding of this review is that it did not uncover a single case of a bank stock analyst expressing strong concerns before Tr [the time when serious problems should have been apparent to a careful observer] about the problems that later became evident. In the great majority of cases the stocks were being recommended for purchase or hold, often because of growth in earnings or interstate banking potential. Negative comments generally related to the stock being overpriced rather than concern about future problems."[47]

As the surrogate for debtholders, the federal government requires timely and accurate information about (1) the financial condition of each enterprise, and (2) the extent that the amount of enterprise risk exposure is increasing, either because of management decisions or as a consequence of external market circumstances.

## 2. Supervisory Requirements

Meaningful disclosure of the government's risk exposure is an important first step. Each enterprise should be required to provide a report of condition at least quarterly, much as is provided by federally insured depository institutions.

Banks and thrifts are required to file quarterly reports of condition and income with their federal regulator, and also to report material changes in financial circumstances. The regular reports provide basic financial information in somewhat greater detail than is usually found in annual reports to shareholders.

Such reports should be supplemented by full disclosure of current off-balance sheet activities such as the issuance or guarantee of pass-through securities. Today, for example, Fannie Mae undertakes much of its lending by guaranteeing hundreds of billions of dollars of mortgage-backed securities. However, the contingent liability from these securities is not included on its balance sheet.

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[47] Richard E. Randall, "Can The Market Evaluate Asset Quality Exposure in Banks," *New England Economic Review*, Federal Reserve Bank of Boston, July/August 1989, p. 11.

In one respect, government sponsored enterprises are well situated to improve upon disclosures now required of banks and thrifts. In particular, market value accounting, supplementing usual reports based on historical cost accounting, can provide significant useful information for financial regulators.

Market value accounting is an important means of addressing issues such as the interest rate mismatch seen in earlier periods of Fannie Mae's and the Farm Credit System's operations. Ultimately, market value accounting should also be used to help accelerate recognition of credit quality problems that otherwise do not have to be accounted for until loans are actually foreclosed.[48]

In addition to market value accounting, each enterprise should report on credit risk, interest rate risk, and business risk. A variety of techniques are available. Credit risk, for example, can be estimated through a worst-case-scenario analysis similar to that used by rating agencies such as Standard & Poor's. Credit quality can be assessed by evaluating an enterprise's loan portfolio and loan pools backing its mortgage-backed securities. Interest rate risk can be measured by simulations of the market value of an enterprise for a range of interest rates and yield curves.[49]

Application of rigorous reporting and disclosure requirements including market value accounting may result in the publication of unfavorable information. However, as the experience of the FCS in the mid-1980s has shown, government sponsored enterprises will continue to be able to issue debt obligations even after such disclosure. The government's implicit guarantee is strong enough that investors in enterprise obligations are unlikely to be discouraged even when market value accounting reveals a low net worth or other measures show a high degree of risk. While equity holders may be adversely affected, it is in their interest too to learn promptly of adverse material changes in financial condition of an enterprise. Prompt disclosure can help management and federal regulators become sensitive to problems, and the need to contain risk, before they grow to unmanageable proportions.

There would probably be few significant costs in generating market-based accounts. Market value estimates can be made more easily for relatively standardized enterprise loans such as guaranteed student loans or residential mortgages or collateralized thrift advances, compared with difficulties of application to bank portfolios consisting of a wide variety of assets.[50]

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[48] See e.g., George J. Benston, et al. *Perspectives on Safe and Sound Banking*, American Bankers Association, at pp. 203-225 (1986).

[49] In this regard, an excellent graphic model of one such scenario analysis is found in the *1990 Annual Report of the Secretary of the Treasury on Government Sponsored Enterprises*, in the chapter on Freddie Mac. Chart 2, p. B-44 shows an interest rate sensitivity curve that could usefully be generated for each government sponsored enterprise.

At relatively little cost, the federal government can use the reports of the individual enterprises to generate estimates of risk exposure for all enterprise operations. Summarized in an annual report, these estimates could permit federal policymakers to devote special attention to enterprises incurring notable excess risk. Risk assessments should be made for particular activities of each enterprise, thereby permitting the regulator to report to the Congress on enterprise lines of business that the regulator considers excessively risky.

In its 1990 recommendations, the U.S. Treasury Department proposed a disclosure requirement tailored expressly to the government's role as a surrogate for debtholders. The Treasury recommended requiring each enterprise to obtain a financial rating of its obligations, without regard to the implicit federal guarantee, from two nationally recognized rating companies. Such information can help compensate for missing debtholder surveillance by substituting the kind of disclosure used by investors in debt obligations of financial institutions, when those debt obligations are not backed by the federal government. Publication of the rating results would add to existing market discipline as well.

## 3. Possible Adaptations of the Bank Supervisory Model for Some Enterprises

Officials of a number of the enterprises utilize sophisticated financial models, including scenario analyses of credit risk and interest rate risk and frameworks for market value accounting and reporting, that could lend themselves to regulatory reporting and disclosures.

One approach to regulating at least some of the enterprises would be to require them to report the application of some of these models to enterprise activities as a means of assessing possible exposure to credit risk, interest rate risk, and possibly other risks. The regulator would assure that appropriate models were used and that they were updated as necessary. The regulator would also need to employ a variety of techniques to generate and validate such models. Validation would include application of analytic techniques as well as on-site examination to assure that the data were timely and accurate. An enterprise might be required to provide the regulator with annual business plans, updated quarterly and whenever material departures from the plan were contemplated. As it found necessary, the regulator would request added information concerning financial risks and aspects of safety and soundness relating to the business plans. The enterprise would then utilize the models prescribed by the regulator to assess the consequences of new business plans for those kinds of financial risks. These disclosures would complement the traditional reports provided by financial institutions to their regulators and their disclosures to investors.

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[50] See Lawrence J. White, "The Case for Mark-to-Market Accounting," *Secondary Mortgage Markets*, pp. 2-4 (Summer 1990). Many of the arguments against applying mark-to-market accounting to banks and thrift institutions do not apply to government sponsored enterprises to the extent that their assets are much easier to value, e.g., because they are purchased in the secondary market. See e.g., "The Case Against Mark-to-Market Accounting," Linda A. Garvelink, *Ibid.*, pp. 5-7.

Finally, the Treasury Department proposal to use nationally recognized rating agencies would provide an additional valuable source of information on each enterprise. The rating agencies use a combination of quantitative analysis and qualitative assessment of management which could provide useful information about the safety and soundness of each enterprise and about changes over time.

If such a sophisticated approach were used, two issues would require active attention by the regulator: first, models are inherently imperfect; adjustments must be made as markets and financial knowledge change. The regulator must have the technical capacity and legal authority to generate and prescribe use of appropriate models and to deter institutions from providing inaccurate, incomplete, or otherwise unuseful information. Second, the regulator must be prepared to examine an enterprise thoroughly and take other prompt actions, if there are signs that self-reporting is not effective.

## B. Examination of Financial Condition and Risk-Taking

### 1. The Need for Examination

Unfortunately, self-reporting is not always effective. Indeed, self-reporting is likely to be least useful at a time when an institution gets into financial difficulty, and managers are concerned about the consequences of revealing unfavorable information.

This means that enterprise reports should be supplemented by periodic examination. Examination is essential to help provide accurate information to the government before possible problems grow to unmanageable proportions. Examination permits the regulator to investigate the policies and procedures used by the enterprise to assure that management is properly implementing the regulations to assure financial soundness. Examination can address management practices relating to asset quality, interest rate risk, management information and control, and other aspects of enterprise risk-taking. As was seen in problems of federal oversight of thrift institutions and banks, examination requires adequate staffing by capable federal officials.[51]

## 2. The Scope of Examination

Examiners seek to ascertain the financial state of an institution, the quality of its management and its compliance with laws and regulations, and to identify whether corrective actions may be needed. Examiners evaluate asset quality (i.e., credit risk), profitability of an institution, its capital levels, and the quality of its management information and control systems. Thrift institution examiners pay special attention to the extent an institution incurs interest rate risk from its loan portfolio.

There is a consensus among bank regulators that the single most important factor in bank safety and soundness is the quality of bank management, its abilities, policies, procedures, and controls.[52]

Bank regulatory agencies conduct their examinations both on-site and off-site. For example, the Comptroller of the Currency now maintains a continuous on-site presence at the largest money center banks, most of which are much smaller than the largest enterprises, such as Fannie Mae and Freddie Mac. Federal regulators increasingly recognize that it is important to examine the financial environment and the ability of an institution to withstand changes in that environment.[53] Problems with financial institutions in various regions of the United States, and with specialized lenders such as thrift institutions in various parts of the country, reflect the need to monitor such market risk. The Federal Deposit Insurance Corporation calls this approach a "forward-looking form of supervision."

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[51] See, e.g., House Committee on Government Operations, *Combatting Fraud, Abuse, and Misconduct in the Nation's Financial Institutions: Current Federal Efforts Are Inadequate,* H.R. Rep. No. 100-1088, 100th Cong., 2d Sess., pp. 13-15 (1988).

[52] See e.g., Federal Deposit Insurance Corporation Staff Study, *Deposit Insurance for the Nineties: Meeting the Challenge*, p. 127 (January 4, 1989 Draft), See also, U.S. General Accounting Office, "Failed Financial Institutions: Reasons, Costs, Remedies and Unresolved Issues," Testimony of Frederick D. Wolfe, Before the House Committee on Banking, Finance and Urban Affairs, January 13, 1989 and sources cited in footnote 22, supra.

[53] This issue was raised many years ago by Mark J. Flannery and Jack M. Guttentag, "Identifying Problem Banks," *Proceedings of a Conference on Bank Structure and Competition*, Federal Reserve Bank of Chicago, pp. 1-32 (May 1979). Flannery and Guttentag call banks subject to market risks "Beta banks," in constrast to "Alpha banks," or institutions with a relatively high probability of failure even without a change in market environment. Flannery and Guttentag suggest that the regulator of an institution particularly subject to market risk should attempt to identify potential future shocks and the extent that the institution should be and actually is prepared to weather such shocks.

"Because of the way banks now function, supervisors must focus more on risk and the root causes of risk before serious problems develop. Instead of just looking at individual transactions, increased attention is given to systems and controls. On-site examinations remain the most important element in the process, but they must be augmented by the best possible system of offsite monitoring and other participatory indeavors. Instead of performing onsite examinations based on a fixed examination cycle policy, more emphasis is now placed on identifying economic and industry risk and identifying individual banks that exhibit symptoms of higher risks. Supervisory resources are concentrated on these risks...."[54]

For all of its importance, the examination process has its limitations. To cite but one prominent example, bank examiners failed to detect the deteriorating quality of loans held by the Continental Illinois National Bank.[55] A congressional staff report criticized federal examiners for concentrating on reviews of loans with the highest apparent risk, and failing to take a fully-representative statistically-valid sample of loans to compare the examiners' ratings of the sample loans with the bank's assessment of the same loans.[56]

Another problem with bank examination is the problem of "regulatory lag." Examiners tend to go by the book, and examination manuals are designed to detect the forms of risk which caused problems in the past, rather than today's emerging problems. This problem can be exacerbated because managers have an incentive to shift risk into areas less susceptible to detection by examiners. That occurred, for example, in some regulated thrift institutions subject to examination by the Federal Home Loan Bank Board.

## 3. Possible Adaptations of the Bank Supervisory Model for Some Enterprises

If enterprises join in a process of providing accurate and sophisticated risk assessment models, updated as necessary, the examination procedures can become correspondingly more sophisticated and less cumbersome. The examiners may be able to concentrate on testing whether models and management information systems accurately reflect the risks and kinds of exposure that have been reported to the regulator. The federal government will require highly qualified staff familiar with the markets served by each enterprise and with the financial profiles of comparable financial institutions

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[54] Federal Deposit Insurance Corporation Staff Study, *op cit.*, p. 125.

[55] *Staff Report of the Subcommittee on Financial Institutions, Supervision, Regulation and Insurance, House Committee on Banking, Finance and Urban Affairs, Continental Illinois Bank, Report of an Inquiry of its Federal Supervision and Assistance*, Committee Print (1984), p. 73.

[56] *Ibid.*, pp. 91-92.

(such as mortgage insurance companies, for example, with respect to Fannie Mae, Freddie Mac and perhaps Farmer Mac).

Another issue concerns management quality. Management risk is both the most important risk associated with financial institutions, and is also the risk least possible to quantify. Again, federal government will require examiners of considerable sophistication--preferably including some who have had experience assessing the management of large money center banks--to form qualitative judgments about the management of each enterprise. The rating companies are experienced in assessing management quality and, again, the Treasury proposal to require annual ratings of each enterprise could supply useful information.

## C. Setting and Enforcing Effective Capital Requirements

### 1. Capital Adequacy Standards for Financial Institutions

Investor capital serves two important functions. First, financial institution managers may have more inclination to be prudent to the extent that they have shareholder capital at stake in lending decisions. To some extent, shareholders have a long-term interest in protecting and enhancing their investment in the company. Second, capital serves as a buffer to absorb financial losses before federal funds are called for. Capital is the equivalent of the "deductible" portion of the federal insurance backing banks and thrift institutions, and implicitly backing government sponsored enterprises.

By themselves, some financial institutions will maintain much lower levels of capital than are adequate to protect the federal government's stake as the guarantor of federally-insured deposits of enterprise obligations. This is because shareholders can benefit from high leverage; they may object to an issuance of new stock as an enterprise grows because that would dilute shareholder returns as the company's profits were spread over a larger number of shares. As shareholder leverage increases, the government loses protection from a cushion of capital that buffers against downside losses.

Similar to any financial creditor, the government must protect against increases in its risk position by limiting risk-taking through a variety of measures including limits it sets on shareholder leverage. That is the reason why capital standards are so important in protecting the government (and taxpayers) against loss from the government-backed obligations of financial institutions.[57]

Only slowly have the economic debates on these issues taken practical form. A major step has been the introduction of risk-based capital requirements to supplement today's minimum capital adequacy requirements. Under the Basle Accords negotiated by banking regulators from 12 different countries including the United States,[58] risk-based capital standards are to be applied according to the credit risk of loan assets held or guaranteed by a financial institution. The risk-based standards are applied on an asset-by-asset basis. Commercial loans, for example, are carried at a benchmark 100 percent of value, high quality residential mortgages are carried at 50 percent of value, government-backed assets such as guaranteed student loans or government-sponsored enterprise obligations and MBSs are carried at only 20 percent of value, and securities bearing the full faith and credit of the government such as Treasury obligations are carried at 0 percent.

This means that, if the base capital is 8 percent of total tangible assets, as it is for commercial banks, banks with a portfolio of commercial loans must maintain capital at 8 percent of total loan value. By contrast, a bank with a portfolio of residential mortgages would have a risk-based capital requirement of only 4 percent (i.e., 50 percent of 8 percent) and a bank with a portfolio of federally guaranteed student loans only 1.6 percent (i.e., 20 percent of eight percent).

To deal with the various kinds of risk on an institution-wide basis, and especially interest rate risk and management and operations risk, the financial institution regulators also impose a minimum capital standard. The minimum capital standard is usually expressed as a leverage ratio of capital-to-assets, with the bank regulators requiring corresponding additional capital to back off-balance sheet items such as letters of credit. The federal financial regulators are now moving to apply the minimum capital standard on a risk-related basis as well. Thus, the federal bank regulators set minimum capital standards on the basis of examination reports and the associated CAMEL ratings.[59]

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[57] See e.g., Karlyn Mitchell, "Capital Adequacy at Commercial Banks," *Economic Review*, Federal Reserve Bank of Kansas City, pp. 17-30 (September/October 1984).

[58] Basle Committee on Banking Regulations and Supervisory Practices, "International Convergence of Capital Measurement and Capital Standards," July 1988.

[59] CAMEL stands for Capital, Asset Quality, Management Quality, Earnings, and Liquidity. Each of those factors is rated on a scale of 1 through 5, with 1 being the most favorable. A composite rating of 1, the highest rating, indicates a sound institution in almost every respect. It is very difficult to achieve a CAMEL rating of 1.

For institutions with a strong CAMEL rating, a rating of 1, the minimum capital standard is set at 3 percent of assets. As the CAMEL rating increases, the federal regulators will increase the amount of capital an institution is required to retain. Regulations of the three commercial bank regulators also state that they will impose higher capital requirements on individual institutions if examination reveals special risk, such as rapid growth, concentration on a single kind of loan, or geographic concentration.[60]

"The standards the Board is adopting are minimum requirements. Any institution experiencing or anticipating significant growth would be expected to maintain capital ratios, including tangible capital positions, well above the minimum levels. In all cases, banking institutions should hold capital commensurate with the level and nature of all of the risks, including the volume and severity of problem loans, to which they are exposed."

A commercial bank must meet both capital requirements. The risk-based capital standards will set the binding level for banks with riskier loan portfolios, while the minimum capital standards will set the level for banks with less risky assets.

The system of capital requirements remains imperfect. Improvements are constantly being proposed. The Federal Home Loan Bank Board, for example, sought to capture some interest rate risk in its risk-based capital regulations proposed in December 1988.[61] The 1989 Financial Institutions Act requires that thrift capital requirements be phased in so that they will be at least as stringent as those applicable to national banks.[62] The federal bank regulators are also attempting to devise ways to include interest rate risk in capital standards. Finally, it is appropriate to apply minimum capital ratios explicitly to off-balance sheet activities, as has been done for the risk-based capital standards, and not just leave application of these capital requirements to informal agency processes.

As discussed below, in 1990, the Treasury Department suggested a somewhat different approach to setting capital standards. The Treasury suggested requiring each government sponsored enterprise to obtain and maintain a high investment grade rating. In the process, the institution would be required to maintain enough capital to meet the standards of the rating agency. In 1991, The Treasury modified its proposal and suggested instead that the regulator set risk-related capital requirements and that an enterprise receiving the highest ("AAA") rating would be exempt from regulatory and capital requirements. Suffice it to note here that for some institutions such as Freddie Mac and Farmer Mac, with negligible interest rate risk, a "AAA" standard would probably require less capital than is required of bank and thrift institutions. On the other hand, enterprises with large portfolio operations, such as the Farm Credit System and Fannie Mae, would probably find bank-type capital requirements easier to meet.[63]

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[60] *See, e.g.*, Board of Governors of the Federal Reserve System, "Capital Adequacy Guidelines; Minimum Tier 1 Leverage Measures and Transition Capital Standards; Final Rule," 55 Federal Register, p. 32828 (August 10, 1990):

[61] Federal Home Loan Bank Board, Proposed Rule, "Regulatory Capital Requirements for Insured Institutions," Federal Register, Vol. 53, No. 247, pp. 51800-51820 (December 23, 1988). The Office of Thrift Supervision has just published a new proposed rule, "Regulatory Capital: Interest Rate Risk Component," Federal Register, Vol. 55, pp. 53529-53571 (December 31, 1990).

[62] Section 301 of Pub. L. No. 101-73; Sec. 5(t) of the Home Owners' Loan Act of 1933.

Finally, the Congressional Budget Office suggests that so-called "stress tests" would be appropriate for helping to set effective capital standards.[64] As is discussed below, such stress tests can provide valuable information about credit risk and interest rate risk. However, they must be used with caution. They depend on analysis of scenarios based on past experience. Such scenarios do not adequately project future patterns of financial stress. Most importantly, stress tests cannot predict the business strategies that an institution's managers may adopt in response to stress caused by unforeseen financial pressures.

Again, the experience of thrift institutions is instructive. In the early 1970s few would have anticipated the unprecedented jump in interest rates coupled with inversion of the yield curve that began in 1979; even fewer could have foreseen the way that thrift managers--often new managers that took control after the institutions faltered--would gamble with federally backed funds. As the Treasury Department concluded in its review of Fannie Mae's stress tests and suggested capital guidelines, "Fannie Mae's management may know that it plans to manage carefully its interest rate risk and credit exposure; however, guidelines are not the same as an outside discipline which would encourage prudent risk management."[65] Stress tests provide useful information, but must be supplemented by other judgments as well.

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[63] See U.S. Department of Housing and Urban Development, "1987 Report on Fannie Mae," pp. 49-51 (September 27, 1989).

[64] Congressional Budget Office, *Controlling The Risks of Government-Sponsored Enterprises*, p. 182.

[65] 1990 *Report of the Secretary of the Treasury on Government Sponsored Enterprises*, p. A-79. The Treasury also found that Fannie Mae's stress test lacked sufficient rigor:

> "Fannie Mae has selected one scenario, in hindsight, with assumptions tailored to that one experience. As the above analysis indicates, changing only one of the underlying assumptions, *ceteris paribus*, can have significant consequences on the capital needed to withstand the scenario. If more than one assumption were altered to reflect a more severe environment, as may be the case in another adverse scenario, the impact on Fannie Mae's capital requirements would be compounded.

Ibid., p. A-78.

## 2. Possible Adaptations of the Bank Supervisory Model for Some Enterprises

One basis for reduced minimum capital requirements, for some enterprises compared to banks and thrifts, relates to the federal government's ability to assess risk-taking promptly and accurately so that sanctions can be applied before great risks are taken, if this is necessary to protect taxpayers' interests. Some enterprises suggest that they are willing and able to furnish extremely sophisticated information to a regulator to provide an accurate and timely basis for assessing the government's risk exposure. Because enterprises--especially those serving the secondary markets--tend to be relatively undiversified in lending compared to commercial banks, federal surveillance of enterprise risk-taking may thereby become more effective than today's oversight of commercial bank activities. This arguably could justify a minimum threshold somewhat below the 3 percent commercial bank minimum.[66] A virtue of this approach would be the continuing incentive that would be provided to enterprise managers to supply high quality information and to obtain a high quality rating on their supervisory reports, and thereby continue to qualify for advantageous capital standards.

Setting of capital standards different from those of commercial banks and other institutions that compete with government sponsored enterprises does raise at least one issue of concern: the financial system must be protected against the ability of financial institutions to arbitrage across capital requirements and shift risk to the point where capital standards are lowest. Thus, if government sponsored enterprises, for example, were permitted a more generous risk-weighting for holding high quality residential or agricultural mortgages, while thrifts and commercial banks were not, the net result might be a shift of high quality mortgages to the government sponsored enterprises and a concentration of lower quality mortgages in the portfolios of the other financial institutions. Logically, if the risk-based and minimum capital standards are properly refined for government sponsored enterprises, there exists no apparent valid policy reason for declining to extend similar treatment to other financial institutions dealing in the same quality of assets or exhibiting the same low risk profile.

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[66] Note that lack of financial diversification can imply greater financial risk compared to the risk profile of a well-run diversified lender. Moreover, even if the federal government had perfect information about enterprise activities affecting levels of financial risk, a significant capital cushion is needed to protect against changes in management risk, market risk and the occurrence of low probability events with potentially serious financial consequences.

## D. Enforcement Powers

While some of the enforcement powers of federal banking agencies and of the Farm Credit Administration are potentially far-reaching, there is a substantial body of case law concerning limits on regulatory authority to use them. Because the original powers granted to bank regulators, such as authority to impose cease-and-desist orders, proved inadequate by themselves to control risk-taking by financial institutions, the Congress has strengthened these powers, for example, by permitting the regulators to impose capital directives,[67] by clarifying that the regulator may use cease-and-desist orders to impose affirmative conditions,[68] and by increasing the amounts of civil money penalties regulators may impose.[69]

As has been learned from experiences with banks and thrift institutions, enforcement powers must be strong enough to permit prompt action while protecting the rights of managers of affected institutions and providing ample and prompt opportunity to obtain redress from any regulatory abuses. Moreover, use of the statutory standards already applicable to banks, thrifts and farm credit institutions will provide the affected parties with some sense of their rights and authority in the event that enforcement powers are contemplated or applied.

Note that except for business plans established under 12 U.S.C. 3709 to restore capital to required levels, use of bank-type enforcement powers would not permit the regulator to second-guess or micromanage enterprise's business plans. Instead, the regulator would concentrate upon designated activities considered to constitute unsafe or unsound practices and seek to correct those explicitly. The arms-length relationship of the regulator means that business decisions must be left to the regulated institution except as they constitute a direct financial risk to taxpayers.

Finally, government sponsored enterprises tend to be huge financial institutions. Their large size means that a regulator can be effective only if controls are available that permit exercise of leverage in a variety of small ways. The Fannie Mae Charter Act, for example, was deliberately designed to permit the regulator such leverage.[70] As HUD itself has found out in dealing with Fannie Mae, the large size of a government sponsored enterprise means that the regulator cannot apply draconian measures without throwing financial markets into disarray. The use of such leverage is also inherent in the relationship of federal regulators to banks, and especially to large banks.[71] For example, as noted in Table 6 at p. 127 below, the FDIC does not have express statutory authority to limit dividends or to disapprove risky activities in advance. Instead, the FDIC will cite risky activities or excessive dividend payments in examination reports. If the level of these payments or activities is high enough to constitute an unsafe or unsound practice, the regulator may curtail them informally, such as through a memorandum of understanding with the institution's board of directors, or formally through a cease-and-desist action.

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[67] 12 U.S.C. 3907.

[68] 12 U.S.C. 1818(b)(6).

[69] The 1989 Financial Institutions Reform, Recovery, and Enforcement Act, Pub. L. No. 101-73, Sec. 907.

[70] Testimony of Robert C. Weaver, Secretary of Housing and Urban Development, Senate Committee on Banking and Urban Affairs, Hearings, "Housing and Urban Development Act of 1968," Part 1, p. 60 (1968).

## 1. The Bank Supervisory Model

The federal bank regulators and the Farm Credit Administration have a variety of enforcement tools at their disposal, including cease-and-desist orders, civil money penalties, removal of directors and senior managers, disapproval of payment of dividends, and authority to impose capital directives. Each of these enforcement powers represents a balance between the interests of taxpayers in assuring safety and soundness and the interest of the regulated institution. Section IV G, below discusses the body of administrative law precedents that helps to protect against misuse of enforcement powers by a supervisory agency.

### a. Cease-and-Desist Orders

12 U.S.C. 1818(b) authorizes a federal banking agency[72] to issue cease-and-desist orders against institutions or affiliated parties[73] with respect to unsafe or unsound practices or violations of law, regulations, written agreements or some written conditions imposed by the agency. For the cease-and-desist powers of the Farm Credit Administration, see 12 U.S.C. 2261.

The cease-and-desist order is a flexible enforcement tool. The federal banking agency may require the affected party to refrain from actions or take affirmative corrective steps. 12 U.S.C. 1818(b)(6) lists the following types of affirmative action: restitution for certain losses, restrictions on growth, disposal of loans or other assets, recission of agreements or contracts, employment of qualified officers and employees (who may be subject to approval by the agency) and other action that the banking agency finds appropriate.

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[71] See e.g. Carter H. Golembe and David S. Holland, *Federal Regulation of Banking*, 1986-1987, pp. 231-2 (1986).

[72] The term "appropriate federal banking agency" includes the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Director of the Office of Thrift Supervision. 12 U.S.C. 1813(q).

[73] The term "institution-affiliated party" is defined in 12 U.S.C. 1813(u).

The banking agencies have used cease-and-desist orders to address a variety of banking problems, ranging from violations of law and weak management to unsound loan administration. Such orders have also included provisions that restricted payment of dividends and required the development of programs to improve earnings.[74]

The agency is required to provide notice and the opportunity for hearing for the institution or affiliated party to contest the issuance of an order. Once a cease-and-desist order becomes final, it is enforceable by court order. 12 U.S.C. 1818(i)(1). The federal banking agency may also punish violations by imposing civil money penalties as discussed below. 12 U.S.C. 1818(i)(2).

### b. Temporary Cease-and-Desist Orders

If the federal banking agency determines that an institution-affiliated party is engaging in unsafe or unsound practices or violating laws, regulations, outstanding orders, written agreements, or some written conditions imposed by the agency, and that these practices or violations are "likely to cause insolvency or significant dissipation of assets or earnings... [or] are likely to weaken the condition of the depository institution or otherwise prejudice the interests of its depositors prior to the completion of [cease-and-desist proceedings under 12 U.S.C. 1818(b)]," the agency may issue a temporary cease-and-desist order (12 U.S.C. 1818(c)). The temporary order may require an institution or party to refrain from actions or to take affirmative action to prevent further harm pending completion of the cease-and-desist proceedings. Temporary cease-and-desist orders are effective and enforceable pending completion of the cease-and-desist proceedings. Within 10 days after an institution or party has been served a temporary cease-and-desist order, that institution or party may apply to the United States District Court for an injunction setting aside, limiting, or suspending the order pending completion of the administrative proceedings under 12 U.S.C. 1818(b). The federal banking agency may apply to the United States District Court for an injunction to enforce its temporary order. 12 U.S.C. 1818(d). For the temporary cease-and-desist powers of the Farm Credit Administration, see 12 U.S.C. 2262-2263.

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[74] An excellent overview is found in Walker F. Todd and Andrew Watts, "Current Intervention and Closure Options of Federal Banking Agencies," Legal Department, Federal Reserve Bank of Cleveland (Unpublished Monograph, 1991).

Finally, 12 U.S.C. 1818(c)(3) permits the federal banking agency to issue a temporary order requiring regulated institutions to place their books and records in a complete and accurate state so that the federal banking agency may determine the financial condition of that institution or details and purposes of transactions having a material effect on the financial condition of the institution. This temporary order is enforceable or may be challenged in U.S. District Court in the same manner as other temporary cease and desist orders.

### c. Removal, Prohibition, and Suspension of Parties Affiliated with the Institution

12 U.S.C. 1818(e) permits a federal banking agency to remove an affiliated party from office in the institution and from participation in the institution's affairs. The agency must determine that a violation or an unsafe or unsound practice or a breach of fiduciary duty that causes financial harm or results in financial gain "involves personal dishonesty on the part of the party or demonstrates willful or continual disregard by the party for safety and soundness of the institution." 12 U.S.C. 1818(e)(1). For the removal powers of the Farm Credit Administration, see 12 U.S.C. 2264-2265 and 2270.

The banking agency must provide written notice of intention to remove the party from office, or to remove or prohibit participation by such party, and provide opportunity for the party to contest the agency's findings at a hearing. Again, under 12 U.S.C. 1818(h) and (i), the affected party may obtain judicial review in U.S. District Court; the appropriate federal banking agency may apply to U.S. District Court to enforce its orders. 12 U.S.C. 1818(i)(1).

### d. Civil Money Penalties

12 U.S.C. 1818(i)(2) provides for a graduated system of civil penalties. A federal banking agency, by written notice, may assess or impose civil penalties on institutions for violations of law, regulation, final or temporary orders, some written conditions imposed, or written agreements. The agency may impose greater penalties on institutions and institution-related parties that recklessly engaged in unsafe and unsound practices, systematically breach fiduciary duties in such a way as to cause more than minimal loss to the institution or result in pecuniary gain or other benefit, or that knowingly or recklessly cause substantial loss to an institution or result in pecuniary gain or other benefit. For the powers of the Farm Credit Administration, see 12 U.S.C. 2268.

12 U.S. 1818(i)(2)(e) provides that the federal banking agency shall provide written notice and opportunity for hearing within 20 days after issuance of a notice of assessment. The agency, in determining the amount of

12 U.S. 1818(i)(2)(e) provides that the federal banking agency shall provide written notice and opportunity for hearing within 20 days after issuance of a notice of assessment. The agency, in determining the amount of penalty imposed, shall consider mitigating factors specifying in 12 U.S.C. 1818(i)(2)(G).

### e. Capital Directives

12 U.S.C. 3907 requires the federal banking agencies to establish minimum capital levels. The federal banking agencies, at their discretion, may deem the failure of an institution to maintain its capital at or above the prescribed minimum level to be an unsafe and unsound practice within the meaning of 12 U.S.C. 1818. For the powers of the Farm Credit Administration to impose capital directives, see 12 U.S.C. 2154(b).

12 U.S.C. 3907(b)(2) authorizes the federal banking agencies to issue a directive to an institution failing to meet its capital requirements. "Such directive may require the banking institution to submit and adhere to a plan acceptable to the federal banking agency describing the means and timing by which the banking institution shall achieve its required capital level." (12 U.S.C. 3907(b)(2)(B)(i).)

Directives, and plans submitted pursuant to such directives, are enforceable in U.S. District Court under the provisions of 12 U.S.C. 1818(i) to the same extent that a final effective outstanding order issued under 12 U.S.C. 1818(b) is enforceable.

Before this provision was added by the 1983 International Lending Supervision Act, banks could disregard regulators' requests for increased capital.

> "Because increasing capital often hurts bank shareholders by diluting earnings, bankers' responses [before 1983] to requests for additional capital were based on a careful weighing of the costs of compliance and non-compliance."[75]

It is possible that the Congress will again strengthen enforcement powers relating to maintenance of adequate capital. Some bank supervisors are concerned that they have insufficient authority to require exceptionally risky banks to increase capital to appropriate levels.

> "They contend that the litigious nature of U.S. business coupled with the standards of evidence required in administrative law proceedings make it almost impossible to impose any penalties on banks whose activities are both legal

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[75] Mitchell, "Capital Adequacy at Commercial Banks," *op. cit.*, p. 19.

> and profitable. That is, the mere potential to suffer losses through, for example, excessive concentration in commercial real estate may not be sufficient grounds to sustain a supervisory order to increase capital. Only actual losses are grounds to sustain such an order, and by that time it may be too late to avoid insurance losses. Some supervisors go so far as to say that this is the problem which has caused insurance costs to go out of control."[76]

### f. Other Enforcement Provisions

12 U.S.C.1818(n) provides for ancilliary powers including authority to administer oaths and affirmations, take or cause to be taken dispositions, and to issue subpoenas and compel the appearance of witnesses and production of documents. These powers are enforceable in court.

## 2. Adapting the Bank Supervisory Model for Enterprises

Discussing the regulator's enforcement powers, it is again useful to distinguish between enterprises with low-risk profiles (comparable to banks with a very low CAMEL rating or companies with a very high credit rating) and the others. As noted above, a regulator's involvement with an institution generally should increase as the institution's capital declines below prescribed levels or as other risk factors increase. For the most safe and sound enterprises, exchanging safety and soundness information with the regulator without acrimony in an atmosphere of arms-length respect, enforcement powers are unlikely to be called upon.

As an institution began to increase its risk factors, either intentionally or as a result of adverse market circumstances, or as capital fell below prescribed levels, the relationship of the enterprise and the safety and soundness regulator would begin to look more like the relationship of banks to their regulators. Bank-type examinations would begin to replace reliance primarily on sophisticated computer models and other informal communications; regulators may require the institution to establish business plans intended to restore required capital levels. Finally, other parts of 12 U.S.C. 1818 provide for termination of status as an insured depository instittition and for criminal penalties that may not be completely relevant to the regulation of government sponsored enterprises to date.[77]

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[76] U.S. Treasury, "Modernizing the Financial System: Recommendations for Safer, More Competitive Banks," p. I-15 (1991).

## E. Requirement of Safeguards or Disapproval of Enterprise Lines of Business that Appear Too Risky

In one respect it may be appropriate to add to the range of bank supervisory authority. This relates to the specialized lending activities and huge size of several enterprises. Because of their specialized lending, the first indications of loss from risky activities may be followed quickly by losses affecting a large part of the institution's business. By contrast, a diversified lender may not face the same prospect of a problem--of interest or credit or operations risk, for example--sweeping much of its business at once.

Thus, it may be easiest to address risk-taking by enterprises before rather than after losses actually occur. Today, federal regulators of several government sponsored enterprises may have considerable statutory authority to approve or disapprove business activities of the regulated institutions. On the one hand, prior approval authority may help to protect taxpayers against financial loss resulting from risky activities. On the other hand, such prior approval authority should not be permitted to degenerate into a form of micromanagement of business decisions by responsible enterprise managers. The heavy use of prior approval authority by the Farm Credit Administration before the Farm Credit System failed in 1985 stands as a warning of the kind of problem that can be caused by excessive use of such authority.

If structured carefully, prior appoval authority may be a useful safety and soundness tool. For example, if sophisticated models are available to project interest rate and credit risk and possibly other forms of risk, such models could help in setting standards for a regulator's exercise of prior approval. A regulator might require, for example, that the interest rate risk or credit risk of a proposed new business activity be confined to specified limits, as reflected in the relevant models, or that the new activities be accompanied by levels of capital commensurate to the likely risk. The regulator might supplement this prior approval with special reporting requirements or examinations to assure that as the programs are implemented risks are not substantially greater than initially projected.

It is probably not useful--except for possiblly extreme cases such as an application to trade highly volatile derivative securities[78]--for approval to be sought or granted on a product-by-product basis. Most government sponsored enterprises are huge institutions. So long as reasonably projected losses are significantly less than the available shareholder capital, those losses are likely to be borne by shareholders rather than by taxpayers. On the other hand, the regulator has the responsibility to protect taxpayers against the unknown risk of entry by the enterprise on a large scale into new and untried businesses. As the thrift debacle and the experience of some failed banks have shown, substantial losses can place pressure on previously prudent managers to compound financial risks in an effort to extract themselves from a difficult situtation.

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[77] Criminal penalties might be limited to those now applicable to Farm Credit System officials in 12 U.S.C. 2269.

[78] See, e.g., sources cited in footnotes 25 and 35, *supra*.

To protect against abuse of regulatory discretion, a regulator's decision with respect to prior approval should be subject to judicial review the same way that cease-and-desist orders and other agency actions are reviewable. For a safety and soundness regulator, the legislative history might clarify that the prior approval power should be confined to addressing issues of financial soundness and used to limit unnecessary risk-taking.

## F. Ability to Deal With A Faltering or Failed Institution: Authority to Appoint a Conservator or Receiver

A major lesson from the thrift industry debacle and the experience of some failed banks is that the likelihood of irresponsible behavior increases substantially as the proportion of shareholder-contributed capital reaches low levels. The federal government must be able to intervene before the net worth of the federally-backed institution drops to zero. At that point, unfortunately, the problems that have brought a financial institution's net worth to zero are likely to continue their impact and create a substantial negative net worth. The level of shareholder capital is an important regulatory indicator.[79] As shareholder capital drops, the regulator must increasingly involve itself with more substantial management decisions. When an institution is well capitalized and otherwise exhibits a low-risk profile, the regulator should not be involved with day-to-day management affairs. As capital levels drop or other risk factors increase, the regulator will have to become more actively involved.

Like other federally-backed financial institutions, government sponsored enterprises do not automatically go out of business when they fail. This permits an enterprise to continue issuing huge volumes of government-guaranteed debt and mortgage-backed securities unless constrained by a statutory provision such as a minimum capital requirement.[80]

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[79] See U.S. Treasury, Modernizing the Financial System: Recommendations for Safer, More Competitive Banks," Chapter II.

The experience of the Federal Home Loan Bank Board with thrift institutions shows the importance of permitting the federal government to intervene before the net worth of a federally-backed institution drops to zero. At that point, unfortunately, the problems that brought the enterprise's net worth to zero are likely to continue their impact and create a substantial negative net worth. One valuable concept considered by the Federal Home Loan Bank Board, was to permit the federal regulator to appoint a conservator or receiver for a failing institution once its capitalization had declined to a specified point.[81] The U.S. Treasury has now recommended similar early resolution for failing banks.[82]

Once again, the standards applicable to bank regulators, and to the Farm Credit Administration, provide guidance for regulatory intervention. The law sets out strict tests that the regulator must meet.[83] An affected institution may

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[80] The Fannie Mae Charter Act contains a debt-to-asset limit that precludes issuance of new obligations if, as a result, the outstanding debt of the enterprise would exceed its assets. This provision is ineffective in limiting losses because it fails to preclude issuance of guaranteed mortgage-backed securities by the enterprise, even if its net worth is zero or negative. The Freddie Mac Charter Act does not contain this limitation at all. Compare 12 U.S.C. 1719(b) (Fannie Mae) with 12 U.S.C. 1452(b)(5) (Freddie Mac).

[81] Under the Federal Home Loan Bank Board proposal, that point would have been reached when capital dropped to 1.5 percent of assets based on book value.

[82] "Modernizing the Financial System," pp. 40-41.

[83] Grounds for appointing the FDIC as conservator or receiver of a failing institution are:

> (A) Insolvency in that the assets of the institution are less than the institution's obligations to its creditors and others, including members of the institution.
>
> (B) Substantial dissipation of assets or earnings due to--
>
> (i) any violation of any law or regulation; or
>
> (ii) any unsafe or unsound practice.
>
> (C) An unsafe or unsound condition to transact business, including substantially insufficient capital or otherwise.
>
> (D) Any willful violation of a cease-and-desist order which has become final.
>
> (E) Any concealment of books, papers, records, or assets of the institution or any refusal to submit books, papers, records, or affairs of the institution for inspection to any examiner or to any lawful agent of the appropriate Federal banking agency or State bank or savings association supervisor.
>
> (F) The likelihood that the institution will not be able to meet the demands of its depositors or pay its obligations in the normal course of business.
>
> (G) The incurrence or likely incurrence of losses by the institution that will deplete all or substantially all of its capital with no reasonable prospects for the replenishment of the capital of the institution with Federal assistance

may obtain judicial review in U.S. District Court. (12 U.S.C. 1821(c)(7)). As with respect to other bank regulatory powers, the case law on conservators and receiverships is beginning to specify the limits of regulatory discretion, and affords affected institutions and managers opportunity for redress under the Administrative Procedure Act.[84]

In practice, of course, the Congress is likely to become involved in any regulatory decision to appoint a conservator or receiver for a failing or faltering government sponsored enterprise, if only to assure that the public purposes of that institution continue to be carried out. A major difference between a conservatorship and a receivership is that the conservator attempts to continue oprations of a troubled institution and restore it to financial health; the receiver by contrast, must deal with an institution that has failed and that is unlikely to be financially viable in its existing form. (When an institution is failing it may be difficult for the supervisory agency to know whether conservatorship or receivership is more appropriate until the conservator or receiver actually takes charge). Congressional involvement can range from providing financial assistance that restores the ability of an institution to function to, on the other hand, assuring that other institutions serve the public purposes of a failed institution. Congress did the former with respect to the financial failure of Farm Credit System in the 1980s and the latter in its oversight of the liquidation of the Federal Land Bank of Jackson, Mississippi.

## G. Confining and Structuring Supervisory Discretion

Just as important as authorizing aand empowering the regulator to act decisively is the need to define and structure the supervisor's administrative discretion and to provide for impartial review to protect against abuse. The regulatory agency's enabling legislation can help to define the scope of authority. This was accomplished for the Farm Credit Administration, for example, in the 1985 Farm Credit Amendments, when the FCA was changed from a virtual component of the Farm Credit System, involved in day-to-day

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> (H) Any violation of any law or regulation, or an unsafe or unsound practice or condition which is likely to cause insolvency or substantial dissipation of assets or earnings, or is likely to weaken the condition of the institution or otherwise seriously prejudice the interest of its depositors.

12 U.S.C. 1821(c)(5). The comparable FCA statutory provisions are found at 12 U.S.C. 2183(b).

[84] See, e.g., *Franklin Savings Association and Franklin Savings Corporation, The Director of the Office of Thrift Supervision*, Civ. Act. No. 90-4054-S, United States District Court for the District of Kansas, Memorandum and Order, filed September 5, 1990, discussed below.

management decisions, into an arms-length financial regulator. See 12 U.S.C. 2252. On the other hand, the limited initial grant of authority to the FCA to supervise Farmer Mac, 12 U.S.C. 2279aa-11(a), expanded somewhat in 1990 amendments, stands as a warning that confinement of discretion should not be so great as to hamper an agency from being effective.

The Administrative Procedure Act (APA) provides an important check on abuse of agency discretion. Part VII of the APA, 5 U.S.C. Sections 701-706, permits adversely affected parties to obtain judicial review of agency action; Section 706 sets forth the appropriate standard of review. Thus, in a recent challenge under the APA, a federal court held that a regulator may not oust the management of a financial institution merely because that institution engages in unorthodox lending activities and uses complex financing and accounting techniques.[85]

## 1. Confining the Supervisor's Discretion to Apply Enforcement Powers

The courts have been active in reviewing enforcement actions by the bank supervisory agencies to help protect against misuse of the supervisors' statutory powers. Under 12 U.S.C. 1818, bank supervisory agencies are authorized to issue cease and desist orders, and otherwise apply enforcement powers to deal with "unsafe or unsound practices." The term "unsafe or unsound practices" was authoritatively defined in the legislative history of the Financial Institutions Supervisory Act of 1966, as follows:

> "Like many other generic terms widely used in the law, such as "fraud," "negligence," "probable cause," or "good faith," the term "unsafe or unsound practices" has a central meaning which can and must be applied to constantly changing factual circumstances. Generally speaking, an "unsafe or unsound practice" embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds."[86]

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[85] *Franklin Savings Association and Franklin Savings Corporation v. Director of the Office of Thrift Supervision*, Civil Action No. 90-4054-S, United States District Court for the District of Kansas, Memorandum and Order, filed September 5, 1990.

[86] Congressional Record, October 18, 1966, p. 26474 (Memorandum prepared by FHLBB Chairman, introduced by Senator Robinson). See, e.g., *MCorp Financial, Inc. v. Board of Governors*, 900 F.2d 852, 863 (5th Cir., 1990).

While the term "unsafe or unsound practice" must be applied to an evolving variety of specific fact patterns, judicial decisions have given considerable context to its application. Thus, the alleged practices must be directly related to an institution's financial integrity and the federal government's risk. *Gulf Federal Savings and Loan Association of Jefferson Parish v. Federal Home Loan Bank Boad*, 651 F.2d 259 (5th Cir. 1981); unsafe and unsound practices encompass what may be generally regarded as conduct deemed contrary to accepted standards of banking operations which might result in abnormal risk or loss to a banking institution or shareholders. *First National Bank of Eden v. Department of the Treasury*, 568 F.2d 610, 611 (8th Cir. 1978); cease-and-desist authority does not give the reglator a mandate to address the competitive balance among financial institutions. *Otero Savings and Loan Association v. Federal Home Loan Bank Board*, 665 F.2d 279, 288 (10th Cir. 1981).

As the decisions emphasize, the legislative history of cease-and-desist and other enforcement powers shows a congressional intent to balance a variety of factors including financial risk to the government against the interest of financial institutions in receiving fair treatment from the government and in "receiving a reasonable degree of protection from arbitrary government action."[87] In exercising authority under the law, a federal bank regulator must attempt to maintain this balance. A federal agency is entitled to some deference. However, the regulator "must not become so obsessed with protecting the integrity of the national banking system that individual banks are arbitrarily treated." *First Natonal Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 681 (5th Cir. 1983). Under the Administrative Procedure Act, 5 U.S.C. 706, actions of a federal regulator will be overruled by the courts if they are arbitrary, capricious, or abuses of discretion. Moreover, the regulator may not merely assert reasons to justify enforcement actions; the regulator must make findings supported by subtantial evidence. Finally, although the regulator has considerable discretion to fashion appropriate remedies, courts will scrutinize those proposed remedies and apply the arbitrary and capricious standard. *First National Bank of Bellaire, op. cit.*

Similar limitations apply to a regulator's discretion in reorganizing or closing a failing or failed institution.[88] In a significant recent case, a federal court overruled an action of the Office of Thrift Supervision in placing Frankin Savings Bank into conservatorship. The court found that the regulator "lacked any factual basis which would justify its appointment of a conservator under the three statutory grounds relied on by the regulator [and] that the OTS acted arbitrarily and capriciously in appointing the conservator." The court ordered the Director of the OTS to remove the conservator and return control of Franklin to its former board of directors and management; the regulator has now appealed that case. *Franklin Savings Association v. Director of the Office of Thrift Supervision*, Civ. Action No. 90-4054-S, U.S. District Court, District of Kansas, Memorandum and Order, September 5, 1990. See also *Washington Federal Savings and Loan v. Federal Home Loan Bank Board*, 526 F. Supp. 343 (N.D. Ohio, 1981). (Regulator must base decision to appoint receiver on facts that related to a specific statutory ground for such appointment).

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[87] Legislative history of the Financial Institutions Supervisory Act of 1966, 1966 *U.S. Code Congressional and Administrative News*, p. 3534.

[88] See, e.g., *MCorp Financial, Inc. v. Board of Governors*, 900 F.2d 852 (5th Cir., 1990) Reh. den. 911 F.2d 730 (5th Cir., 1990) (court will not require plaintiff to exhaust administrative remedies, where only issue is legal and does not require factual development; government will be enjoined from prosecuting administrative actions under 12 U.S.C. 1818) and *Sterling Savings Assn. v. Ryan*, 751 F. Supp. 871 (E.D. Wash., 1990) (court will enjoin

It would also be appropriate for the Congress to supplement these judicial decisions with legislative history, perhaps comparable to that of the 1966 Financial Institutions Supervisory Act, that sets further limitations on the regulator's discretion. Especially if the safety and soundness regulator of government sponsored enterprises is separate from the program regulator, it might be useful, for example, for the legislative history to specify that enforcement powers must be exercised solely to address concerns about risk to the federal government and taxpayers, and not with respect to other policy considerations such as competitive balance among financial institutions.

## 2. Structuring the Supervisor's Discretion

The issue of structuring discretion of a federal financial supervisor is more difficult. Federal financial regulators such as the FDIC and OCC, and also the FCA since 1987, have long been reluctant to issue many regulations containing self-imposed limitations on their authority.[89]

Such reluctance is based upon years of difficult experience. As lawmakers and regulators have fashioned categories of proscribed conduct, new technologies and market-based developments have provided the supervised

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government from placing institution into conservatorship or receivership where the institution is likely to prevail on merits of its defense to such action).

[*] Courts in recent cases have articulated the principle that a regulator may be bound by earlier regulatory agreements and have begun to define the contours of this principle. Compare *Security Federal Savings Bank v. Director, OTS*, 747 F. Supp. 656 (N.D. Fla., 1990) and *Far West Federal Bank v. Director, OTS*, 738 F. Supp. 1559 (D. Ore., 1990) with *Flagship FSC v. Wall*, 748 F. Supp. 742 (S.D. Cal., 1990).

[89] For an early example, see Kenneth Culp Davis, *Discretionary Justice: A Preliminary Inquiry*, University of Illinois Press, 1971, pp. 120-126.

institutions the means to engage in practices that comply with the letter of requirements while eviscerating their effectiveness.[90]

One regulatory response has been to seek to retain maximum unfettered discretion without being confined by implementing regulations. While this response may be appropriate for bank regulators given the literally thousands of institutions they must supervise, it is arguably less appropriate for supervision of safety and soundness of government sponsored enterprises.

Because of the large size of several enterprises and the reliance of most on large volumes of similar transactions, it would be helpful for the supervisor to specify in advance some limits, to the extent possible, with respect to risk-taking and unsafe and unsound practices and conditions. Otherwise, the housing or student loan markets, for example, might be unnecessarily buffeted by unforeseen swings in regulatory policy.

One useful approach would be for the enterprise regulator to use the informal rulemaking process of 5 U.S.C. 553 to specify some kinds of "unsafe and unsound" practices and conditions that would be considered grounds for seeking a cease-and-desist order, restricting payment of dividends, or applying other specified sanctions. As Kenneth Culp Davis has argued,

> "Agencies through rulemaking can often move from vague or absent statutory standards to reasonably definite standards, and then, as experience and understanding develop, to guiding principles, and finally, when the subject matter permits, to precise and detailed rules."[91]

Of necessity, these bright lines must be accompanied by a clear regulatory statement that the adminstrative agency reserves authority to act in other cases as well, even though the supervisor has not defined the offending practices beforehand in regulations.[92]

Especially because several of the enterprises are large institutions, the use of rulemaking to specify areas of concern to the supervisor can usefully supplement the exercise of authority when required reports or periodic examinations turn up examples of excessive risk-taking or unsafe or unsound conditions of a kind that could not have been specified beforehand.

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[90] See e.g., Robert Litan, *What Should Banks Do?*, The Brookings Institution, 1987, pp. 33-59.

[91] *Discretionary Justice*, Op. cit., p. 219.

[92] For example, the FDIC accompanies its few regulations concerning unsafe and unsound practices with a clear reservation of authority to take,

> "whatever action it deems necessary and desirable to deal with specific acts or practices which, although they do not violate the provisions of this part, are considered detrimental to the safety and sound operation of the bank engaged therein."

12 CFR 337.11.

This said, one other caveat must be mentioned. As developments occur in the market place, and innovations take place in financial services, concepts of excessive risk inevitably will change as well. The recent *Franklin Savings* case, in which a federal judge found that the Office of Thrift Supervision had failed to comprehend the nature of sophisticated hedge transactions, stands as an important warning about the need for the regulator promptly to abandon or modify concepts of excessive risk when they are no longer current. On the other hand, market developments may also add to the list of enterprise practices considered excessively risky, just as the federal bank regulators learned the dimensions of interest rate risk and sovereign risk in the 1970s and 1980s.

Even if all contingencies cannot be predicted in advance, the use of informal rulemaking can help set some clear limits on risk-taking and protect the regulated institutions against rapid changes in regulatory philosophy. It will be important to assure that in devising such regulation the financial regulator is confined to safety and soundness issues, and not to the other more politically volatile issues of public purpose that as is argued in Section VII below, are more properly left for congressional decision.

## V. Federal Supervision of Enterprise Safety and Soundness Today

It turns out that federal supervision of safety and soundness of most enterprises today falls far short of the quality of bank and thrift supervision. Information is generally limited and regulators may lack resources and often the mandate and the full complement of statutory powers to address safety and soundness issues and to set effective capital requirements.

### A. The Quality of Federal Information

There is no single source of information within the federal government about government sponsored enterprises. This is unfortunate, because enterprises involve issues of law, economics, and finance that come together in unusual ways. Statistics are often unavailable except from the enterprises themselves.

Information about particular enterprises is collected by a variety of federal agencies and organizations. HUD collects information from Fannie Mae and Freddie Mac; the Farm Credit System receives reports of condition from farm credit institutions; and the Federal Housing Finance Board collects information from the Federal Home Loan Banks.[93]

The Office of Management and Budget (OMB) provides a central source of expertise on a variety of federal programs, but does not dedicate the same resources to government sponsored enterprises. As privately-owned, off-budget entities, enterprises are beyond the scope of direct OMB authority. When OMB publishes an annual report on enterprise activities in the Appendix to the federal budget, the office accepts numbers generated by the enterprises themselves and does not independently verify their accuracy.

This has led to significant misperceptions. In the fiscal year 1986 budget, for example, Freddie Mac estimated that its FY 1986 activities would result in a net increase of outstanding mortgage-backed securities of $10.6 billion. In fact, this estimate was over $40 billion below the actual increase in outstanding mortgage-backed securities that year, which amounted to $54.9 billion.[94] While much of this error may have resulted from an unexpectedly high volume of mortgage refinancings in 1986, the point remains that the information was not of useful quality. The practice of accepting enterprise information without further analysis may change as OMB acts to implement its new statutory mandate, added in 1990, to report annually, as a part of the President's budget submission on the financial condition of the GSEs and the financial exposure of the government.[95]

Within the legislative branch, the Congressional Budget Office and U.S. General Accounting Office are increasingly allocating resources to analyzing government sponsored enterprises and their activities. The 1989 Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) has improved on this state of affairs, at least for the short run. Provisions of that act required the U.S. Treasury Department and the U.S. General Accounting Office to publish annual reports, in 1990 and 1991, on the degree and kinds of risks involved in activities of each enterprise, and their market value net worth. The GAO was also required to determine appropriate capital standards that might be applied to each enterprise. In 1990, the Congress also asked the

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[93] 24 CFR Part 81, Subpart C and Appendix B (U.S. Department of Housing and Urban Development, Reporting Requirements for Fannie Mae); 12 CFR Part 621, Subpart B (Farm Credit Administration, Reports of Condition and Performance by Farm Credit System institutions); 12 U.S.C. 1440 (the regulator shall require FHLBs to submit reports of condition at least annually).

[94] Compare *Appendix to the Budget for Fiscal Year 1986*, p. V-14, with *Appendix to the Budget for Fiscal Year 1988*, p. IV-12.

[95] Budget Enforcement Act of 1990, Section 13501(f). The Office of Management and Budget did not independently verify the information provided by enterprises for its first annual report, contained in the FY 1992 budget document.

Congressional Budget Office (CBO) to study enterprises, their risk-taking, and alternative approaches to federal oversight.[96]

## B. The Supervision of Enterprise Safety and Soundness Today

Even with the regulatory failures of the Federal Home Loan Bank Board and the Farm Credit Administration in the mid-1980s, the lessons of those failures have not been especially well applied to regulation of enterprise safety and soundness.

One place where the lesson has been learned is the newly strengthened Farm Credit Administration (FCA). FCA regulates the farm credit institutions and Farmer Mac under statutory powers similar to those of the federal bank regulators. It can bring cease and desist proceedings, suspend or remove FCS institution officers and directors, impose civil money penalties, set and enforce capital adequacy standards, and appoint conservators or receivers.[97] The agency is permitted to assess the regulated FCS institutions for supervisory costs, including the cost of examinations, and to pay FCA expenses from those assessments.[98]

By contrast, the Department of Housing and Urban Development (HUD) has authority but, until recently at least, has shown little inclination to supervise safety and soundness of Fannie Mae. HUD has general regulatory authority to see that the purposes of the Fannie Mae and Freddie Mac charter are carried out, but lacks a clear mandate to supervise Fannie Mae's or Freddie Mac's financial soundness.[99] HUD also lacks the resources. Unlike other financial institution regulators, for example, HUD is not authorized to assess Fannie Mae or Freddie Mac the cost of maintaining a capable regulatory staff that is compensated at competitive levels comparable to salaries of the staff of federal bank regulators. HUD is likely to be overwhelmed by responsibility for two enterprises with combined lending amounting to well over half a trillion dollars.

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[96] On April 30, 1991, the CBO published its report, *Controlling The Risks of Government-Sponsored Enterprises*.

[97] 12 U.S.C. 2261-2274, 2154, and 2183.

[98] 12 U.S.C. 2250 (Farm Credit Administration Operating Expenses Fund).

[99] For example, HUD's *1986 Report to Congress on the Federal National Mortgage Association* (issued June 29, 1987) states:

> "GAO's first specific point was that the Federal Government should have a permanent oversight function on FNMA's operations. This, however, is inconsistent with HUD's regulatory rationale which, again, is grounded in legislative history and HUD experience. GAO does not specifically state the role which would be performed by an oversight staff, but it is doubtful that it could exist without becoming a "watchdog." Congress never intended for HUD to exercise such a role and the Department's negative experience in trying to control FNMA closely during the late 1970s highlights the futility of trying to do so." 1986 *Report* at pp. 167-8.

HUD was responding to the 1985 Report of the U.S. General Accounting Office, *The Federal National Mortgage Association in a Changing Economic Environment*, April 15, 1985.

During the 1980s, responsibility for overseeing Fannie Mae shifted among various HUD offices, without the Department developing an experienced supervisory staff able to monitor and regulate financial risk-taking by the enterprise. Indeed, in 1989 the *Washington Post* reported that HUD lacked even a single full-time official responsible for overseeing Fannie Mae and Freddie Mac.[100] HUD has never used its examination authority over Fannie Mae, even though that authority has been available since 1968. HUD has tended to concentrate on national housing policies, such as a controversy over Fannie Mae's support of low-income housing in the late 1970s, rather than on narrower matters such as Fannie Mae's financial safety and soundness.

With passage of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), HUD has devoted increasing attention to the issue of safety and soundness of Fannie Mae and Freddie Mac. On June 21, 1990, the department published a notice of hearings on regulations to deal with a variety of matters including capital adequacy, reporting requirements, and enforcement mechanisms.[101] The hearings were divided into two parts, with Fannie Mae and Freddie Mac presenting their views privately to HUD,[102] followed by a public hearing for other witnesses on July 20, 1990. HUD has not yet published proposed rules.

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 created a new federal agency, called the Federal Housing Finance Board, to oversee safety and soundness and the activities of the Federal Home Loan Bank System. The FHFB today has only a few examiners to inspect the entire

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See also, e.g., Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, "Financial Institutions Reform, Recovery and Enforcement Act of 1989: Supplemental Report," Rept. 101-54, Part 3, June 1, 1989, p. 3.

[100] Jerry Knight, "Bailout of S&Ls Spurs Probes of Other Programs: Hill Examines Taxpayer Liability in Huge U.S.-Backed Enterprises," *The Washington Post*, pp. H-1, H-4, October 15, 1989. "It's not as if we have to have someone watching them every day," a HUD spokesman told the *Post*.

[101] *Federal Register*, Vol. 55, No. 120, p. 25377 (June 21, 1990).

[102] On July 20, 1990, HUD announced that a transcript of the Fannie Mae and Freddie Mac testimony would be made public at a later date. That transcript, with some deletions, was made available several months later.

FHLBS and its $166 billion of loan assets. Finally, Sallie Mae has no financial regulator at all.[103]

Tables 4, 5, and 6, at pp. 660-662, summarize the relevant statutory provisions providing each enterprise regulator with institutional capability and administrative authority. To provide a frame of reference, each table also lists comparable statutory authority of the Federal Deposit Insurance Corporation, a federal bank regulator.

Table 4 summarizes provisions relating to institutional capability. The FCA and FHFB have virtually all of the benefits available to the FDIC: (1) funding from assessments on the regulated institutions, rather than federal appropriations, (2) freedom from Executive Branch budget controls, (3) freedom to set their own staffing ceilings (except that an appropriations act periodically sets FCA staff ceilings), and (4) freedom to set salary schedules above civil service levels, at levels comparable to those paid by the federal bank regulators. Only HUD, responsible for supervising the two largest enterprises, lacks these statutory benefits. HUD is funded by federal appropriations, subject to Executive Branch budget controls, limited to staff ceilings specified in the federal budget process, and limited to salaries at civil service levels.

Table 5 summarizes the regulatory authority provided for each enterprise regulator. The FCA has statutory authority closest to that available to federal bank regulators, including authority to prescribe reports, examine financial condition, set binding capital requirements, and appoint a conservator or receiver. The statutory authority of FCA with respect to Farmer Mac is less clear in some important aspects because of the language of 12 U.S.C. 2279aa-11 and some of the related legislative history.

The FHFB also has supervisory authority close to that of the federal bank regulators. Again, it is HUD that lacks authority, to set binding capital requirements or to appoint a conservator or receiver. Moreover, HUD's express authority, to examine Fannie Mae and Freddie Mac, for example, is less complete than that of the other regulators.[104] This can lead to unnecessary controversy in the event that HUD ever decides to examine the two enterprises. Especially at a time of financial urgency, such controversy could disrupt the regulator's effective performance.

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[103] The Higher Education Act, 20 U.S.C. 1087-2(h)(2), provides that:

"Nothing in this section [with respect to Department of Education and Treasury approval of Sallie Mae obligations] shall be construed so as to authorize the Secretary of Eduation or the Secretary of the Treasury to limit, control, or constrain programs of the Association or support of the Guaranteed Student Loan Program by the Association."

[104] Compare HUD's authority under 12 U.S.C. 1723a(h) with that of the FHLB under 12 U.S.C. 1440:

> 12 U.S.C. 1723a(h): "The Secretary may examine and audit the books and financial transactions of the Corporation and he may require the Corporation to make such reports on its activities as he deems advisable."

Table 6 sets forth some of the major enforcement powers available to the various regulators. Again, the FCA is closest to the bank regulators in the range of its powers. The other enterprise regulators lack most of the express enforcement powers available to the FDIC. That means that, in the hopefully rare but potentially troublesome event of clear noncompliance by an enterprise, the federal government lacks the ability to apply most of the kinds of sanctions that have been necessary in dealing with some other financial institutions. Instead of addressing such matters through federal agency action, this probably means turning to the Congress at a time of exigency to obtain necessary new powers. In a sense, this happened when the Farm Credit System failed in 1985; the Congress then fashioned remedial statutory provisions, but only after taxpayers had been exposed to losses that might have been prevented.

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12 U.S.C. 1440: "The Board shall from time to time, at least annually, require examinations and reports of condition of all Federal Home Loan Banks in such form as the Board shall prescribe and shall furnish periodically statements based upon the reports of the banks to the Board. For the purposes of this chapter, examiners appointed by the Board shall be subject to the same requirements, responsibilities, and penalties as are applicable to examiners under the National Bank Act [12 U.S.C.A. 12 et seq.] and the Federal Reserve Act [12 U.S.C.A.221 et seq.], and shall have, in the exercise of functions under this chapter, the same powers and privileges as are vested in such examiners by law."

## Table 4
### *Institutional Capacity*

| Regulator | Sources of Funds | Executive Branch Control of Budget | Sets Own Staffing Ceilings | Sets Own Salary Schedules Comparable to Bank Regulatory Agencies |
|---|---|---|---|---|
| FDIC | Assessments on Regulated Institutions 12 USC §1817 | No - OMB Circular A-11, §11.2 | Yes | Yes, 12 USC §1833b |
| FCA | Assessments on Regulated Institutions 12 USC §§2250, 2279aa-11(d) | No - OMB Circular A-11, §11.2 | No - Limited by Annual Appropriations Act | Yes, 12 USC §§1733b & 2245(c) |
| FHFB | Assessments on Regulated Institutions 12 USC §§1422b(c) & 1438(b) | No - 12 USC 1422b(c) | Yes - 12 USC §1422b(b) | Yes - 12 USC §1422b(b) |
| HUD | Federal Appropriations | Yes | No | No |

Note: The federal government has not established a financial regulator for Sallie Mae

## Table 5
### *Supervisory Authority*

| Regulator | Prescribe Reports | Examine | Set Binding Capital Requirements | Appoint A Conservator or Receiver |
|---|---|---|---|---|
| FDIC | Yes, 12 USC §1817(a) | Yes, 12 USC §1820(b) | Tesm 12 YSC §3907(a) | Yes, 12 USC §1821 |
| FCA | Yes, 12 USC §§2254(b), 2257a & 2279aa-11(c) | Yes, 12 USC §§2254(a) & 2279aa-11 | Yes, 12 USC §2154(a); less clear for Farmer Mac | Yes, 12 USC §2183; but not for Farmer Mac? |
| FHFB | Yes, 12 USC §1440 | Yes, 12 USC §1440 | No, but see 12 USC §1436(a) setting statutory capital levels | May liquidate or reorganize 12 USC §1446 |
| HUD | Yes 12 USC §§1452(b)(4) & 1723(a)(h) | Yes 12 USC §§1452(b)(4) & 1723(a)(h) | No (see discussion in text) | No |

Note: The federal government has not established a financial regulator for Sallie Mae

## Table 6
*Enforcement Powers*

| Regulator | Capital Directives | Issue Cease and Desist Orders | Remove Directors or Officers | Impose Civil Money Penalties | Restrict Dividends | Disapprove Risky Activities |
|---|---|---|---|---|---|---|
| FDIC | Yes, 12 USC §3907(b) | Yes, 12 USC §1818(b)(c)(d) | Yes, 12 USC §1818(e) (f), (g), (h) | 12 USC §1818(i) | Not Directly | Not Directly |
| FCA | Yes, 12 USC §2154(b) | Yes, 12 USC §§2261-2263 | Yes, 12 USC §§2264-2265 | Yes, 12 USC §2268 | Not Explicitly; but see 12 USC §2154(a)(d) | Yes, for financially related services; otherwise, not directly |
| FHFB | Not explicitly; but see 12 USC §1432(a) | Not explicitly; but see 12 USC §1432(a) and 12 USC §1422(b)(a)(1) | Yes, 12 USC §1422(b)(a) | No | Yes, 12 USC §1436(a) | Yes, 12 USC §1432(a) |
| HUD | No | No | No, but see 12 USC §1723(b), (President may remove Fannie Mae director for good cause) | No | Yes, 12 USC §1452(b)(3) | Yes, for Fannie Mae: 12 USC §1717; ambiguous for Freddie Mac: 12 USC §1452(b) |

Note: The federal government has not established a financial regulator for Sallie Mae

## C. Current Enterprise Capital Requirements

The federal government has not set consistent capital requirements for government sponsored enterprises. Today, Fannie Mae is subject to a debt-to-capital ratio. However, the statute permits Fannie Mae to count subordinated obligations as a part of its capital, and (in contrast to banks) the subordinated obligations are implicitly backed by the federal government. This renders the capital requirement virtually meaningless.[105]

The 1989 FIRREA legislation now applies similar requirements to Freddie Mac. Freddie Mac especially will benefit from the fact that the statutory debt-to-capital requirement does not apply to off-balance sheet activities. This means that the debt-to-capital requirement will apply to Freddie Mac's $40.6 billion of assets, but not to the Corporation's $316.4 billion of guaranteed mortgage-backed securities outstanding at the end of 1990.

The absence of capital standards is reflected in the low capitalization of Fannie Mae and Freddie Mac today. Fannie Mae, for example, at yearend 1990 had only $4.1 billion of shareholder capital to support $433 billion of assets and guaranteed securities; Freddie Mac had only $2.1 billion of shareholder equity to support $357 billion of assets and guarantees. This is substantially below the capital requirements established for commercial banks by the FDIC, Comptroller of the Currency, and the Federal Reserve Board, or for thrifts by FIRREA.[106]

The Farm Credit Administration is responsible for setting capital standards for Farm Credit System institutions. FCA has promulgated regulations requiring that most FCS institutions meet minimum risk-based capital requirements.[107] Those requirements involve a minimum ratio of permanent capital to risk-weighted assets of 7 percent, to be achieved by 1993. They also provide forbearance criteria for institutions that do not meet the capital adequacy standards during a transition period. The 1990 Treasury Report raises the question whether FCS borrower stock is truly at risk in the same way that investor equity capital would be.[108] The Farm Credit Administration has not set any capital standards for Farmer Mac, the newest government sponsored enterprise, and would benefit from express authority to do so by regulation.

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[105] As one investment analyst has pointed out,

> "Contrary to appearances, however, Fannie Mae has little reason to view capital requirements as a prospective constraint on its future operations. What makes HUD's requirement a red herring is that Fannie Mae is allowed by statute to include subordinated debt in its computation of regulatory capital. While the company's debt-to-equity ratio on a GAAP basis is 45:1, on a regulatory basis, including subordinated debt, it is currently 18:1. Thus, Fannie Mae can always improve its regulatory capital ratio further by raising additional subordinated debt. Fannie Mae pays only 10 to 15 basis points more for subordinated debt than for other debt instruments; the public markets perceive Fannie Mae's subordinated debt as implicitly backed by the federal government, which would almost certainly prove correct if Fannie Mae ran into trouble." First Boston Corporation, "A Flurry or Recent Articles Takes Swipes at Fannie Mae; No Reason for Investor Concern; Maintain BUY Option," April 14, 1989, p. 2.

See also *1990 Report of the Secretary of the Treasury on Government Sponsored Enterprises*, pp. A-72 to A-74 and B-60 to B-62; and U.S. General Accounting Office, *Government Sponsored Enterprises: The Government's Exposure to Risks*, pp. 100-101.

[106] See, e.g., *1990 Report of the Secretary of the Treasury on Government Sponsored Enterprises*, pp. A-86 and A-87 (Fannie Mae) and B-72 and B-73 (Freddie Mac); *see also, 1991 Report of the Secretary of the Treasury on Government Sponsored Enterprises*, Chart 2, p. 12.

The Federal Home Loan Bank System is required by its charter act to maintain a capital reserve, and has maintained substantial capital, amounting to over 7 percent of assets at yearend 1990. Sallie Mae has no capital requirements at all, but on its own has maintained capital that at yearend 1990 amounted to 2.8 percent of its assets.

# VI. The Treasury and General Accounting Office and Congressional Budget Office Reports: Calls for Increased Financial Accountability of Government Sponsored Enterprises

## A. The 1990 Treasury Department Report

In May 1990, the Treasury Department published the *Report of the Secretary of Treasury on Government Sponsored Enterprises*. The Treasury reviewed the safety and soundness of each enterprise. In accordance with its specific statutory mandate, the Treasury reviewed the capitalization of each enterprise as well as specific kinds of risk: credit risk, interest rate risk, management and operations risk, and business risk.[109]

In producing the report, the Treasury operated under significant limitations. Most importantly, the Treasury relied on self-reporting by each enterprise; Treasury officials did not independently verify the accuracy of responses. Also, the statute contained extensive confidentiality requirements that precluded the Treasury from exchanging information within the federal government, for example, with existing enterprise regulators such as the Department of Housing and Urban Development or the Farm Credit Administration, or with other relevant departments such as the Department of Education. Given these limitations, the quality of the 1990 report is especially impressive.

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[107] 12 CFR 615.5200 *et seq.*, Subpart H "Capital Adequacy."

[108] *1990 Report of the Secretary of the Treasury*, pp. D-53 to D-55.

[109] The Treasury study was authorized and directed by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 100-73, Section 1404.

For each enterprise, the Treasury report provided (1) a description, (2) an overview of financial safety and soundness, (3) assessments of business risk, credit risk, interest rate risk, and management and operations risk, (4) analysis of capital adequacy, and (5) discussion of the quality and timeliness of information provided by each GSE to the public and to the federal government. The Treasury also attempted--unsuccessfully as it turned out--to measure the impact of enterprise borrowing on the cost of federal government borrowing.

The Treasury Department report provided a veritable checklist of important elements of financial risks and the extent to which each enterprise can or has kept the risk under control. Among the more important findings:

- *Fannie Mae*: Fannie Mae's biggest credit risk is a regional or national economic slowdown; about 50 percent of Fannie Mae's outstanding mortgages are concentrated in five states. For large interest rate increases (of 3 percentage points), the net market value of Fannie Mae's mortgage business turns negative; for even larger interest rate changes, Fannie Mae's net worth becomes negative. Fannie Mae's ability to use effectively its new management information system needs improvement.[110] Treasury does not consider Fannie Mae's current leverage an imminent threat, but additional capital is necessary.

- *Freddie Mac*: Freddie Mac's mortgage business is geographically more diversified than is Fannie Mae's, and Freddie Mac manages its credit risk. Under current policies, Freddie Mac's exposure to interest rate risk is small. Freddie Mac has adequate controls, monitoring and information systems. The corporation's current degree of leverage does not seem to present an imminent threat but raises concern for the longer term.

- *The Federal Home Loan Bank System*: The Federal Home Loan Banks face problems associated with declining membership and declining demand for FHLBS funding due to contraction of the thrift industry. The FHLBS has successfully controlled credit risk (it has never suffered a loss on an advance) and has effectively managed interest rate risk. The FHLBS successfully controls management and operations risk and is currently well capitalized.

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[110] The Treasury reported, for example, that "...Fannie Mae has not yet developed the ability to query the system for data in an accurate, consistent or timely manner." *1990 Report*, p. A-65.

- *The Farm Credit System*: The Farm Credit System remains exposed to risk of the volatility of the agricultural sector and continues to have credit risk due to its restriction to a single economic sector. The FCS has significantly improved its management of interest rate risk, but needs to do better. Some institutions of the system are exposed to risks associated with lack of effective oversight by their boards of directors, ineffective internal audit functions, and inadequate management information systems. There is some question whether the borrower stock of the FCS, a major component of the system's permanent capital, is at risk in the way that shareholder equity represents true capital; FCS must build retained earnings to protect against losses.

- *Sallie Mae*: Sallie Mae is not exposed to much business risk or interest rate risk. The corporation is protected from credit risk on its federally guaranteed or reinsured student loan portfolio, but should require collateral in swap transactions sufficient to cover its credit risk exposure. Sallie Mae has adequate controls to manage and monitor its operations, and it has a strong capital base and does not need to increase its capital at this time.

## B. The 1990 General Accounting Office Report

The U.S. General Accounting Office (GAO), operating under a similar legislative mandate, released its report in August 1990.[111]

The GAO report similarly analyzed each GSE and (1) its risks and the quality of its risk management, (2) its loss reserves and capital adequacy, and (3) the quality of current federal oversight of its risk-taking and capitalization. The GAO was critical of the quality of current federal oversight of government sponsored enterprises. In particular, the GAO concluded that,

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[111] The General Accounting Office reported under the provisions of Section 1004, Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 100-73, Section 1004.

> "Fannie Mae, Freddie Mac, and Sallie Mae are not subject to (1) adequate federal monitoring of their risk-taking, (2) minimum capital rules that are risk-based, or (3) adequate enforcement authorities. We are concerned that the government would not be prepared to prevent or mitigate losses from a future crisis facing Fannie Mae, Freddie Mac, or Sallie Mae."[112]

Among the GAO findings:

- Fannie Mae, Freddie Mac, and Sallie Mae are subject to much weaker monitoring, capital rules, and enforcement actions than are banks with federally insured deposits.

- The FHLBS is subject to minimum capital requirements, monitoring of activities, and enforcement actions that seem to provide reasonable means for the government to control excessive risk-taking; it is unclear how the new Federal Housing Finance Board, established in August 1989 to regulate the FHLBS, will implement its authority and whether it will be effective.

- Legislation passed in 1985 gave the Farm Credit Administration powers similar to those of federal bank regulators and made it independent of the FCS.

- Sallie Mae has neither a federal regulator nor federally established capital requirements.

## C. The 1990 Treasury and GAO Recommendations

The 1990 Treasury Department proposals, presented to the House Ways and Means and Senate Banking Committees by Robert R. Glauber, Undersecretary for Finance, consisted of four guiding principles and recommendations to reduce risk to the taxpayer and to assure the long-term solvency of government sponsored enterprises. The four principles are:

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[112] U.S. General Accounting Office, *Government Sponsored Enterprises: The Government's Exposure to Risk*, (August 1990), p. 90.

> 1. Each enterprise should be adequately capitalized, meet high credit and operational standards, and be subject to effective government supervision;
>
> 2. A private market mechanism should be used to evaluate enterprise risk; each enterprise should obtain a rating equivalent to triple-A, absent any implicit government guarantee, from at least two of the nationally recognized credit rating companies;
>
> 3. Enterprises should be supervised for financial safety and soundness by a regulator different from the program regulators; in other words, a financial regulator such as the Federal Reserve, Federal Deposit Insurance Corporation, or the Treasury itself should supervise safety and soundness of the enterprises while agencies such as HUD remain responsible for overseeing the programmatic activities of enterprises such as Fannie Mae and Freddie Mac; and
>
> 4. Each enterprise should disclose annually the value of the federal government's credit support; this should be measured as the difference between (1) the cost of funds of the enterprise and (2) the cost of funds of a corporation that has the credit rating that the enterprise has obtained (again, without regard to the government's implicit guarantee).

In 1990 testimony, Assistant Comptroller General Richard L. Fogel largely concurred in the Treasury Department's position. However, the General Accounting Office recommended applying bank-type regulatory requirements and risk-based capital standards rather than relying upon the rating of private rating companies to set capitalization levels. If the Treasury's 1990 recommendations were adopted and private rating companies were used, then Fogel recommended that the enterprises' federal financial regulator examine closely the assumptions used by each rating company and the appropriateness of the final capital standard. The General Accounting Office was prepared to issue more definitive recommendations in 1991.

The two 1990 reports raised a range of administrative issues, especially relating to the preferred institutional regulatory structure.

## D. Regulatory Issues Raised by the 1990 Reports

### 1. Separating Program Regulation from Financial Supervision

In 1990, both the Treasury and the GAO recommended separating program regulation of enterprises (i.e., supervision of the extent and manner in which they serve their public purposes) from federal supervision of safety and soundness. The GAO said with respect to the Department of Housing and Urban Development:

> "...We are concerned about inherent conflicts between HUD's housing policy goals and its goals as a financial regulator. Recent history with the thrift crisis and the Farm Credit crisis has illustrated the disastrous effects of having regulators both promote the industry and be responsible for financial oversight."[113]

The Treasury, possibly to preserve comity within the Executive Branch, refrained from criticizing existing regulators such as HUD or the FCA, but recommended that, as a general principle, "the program regulator should be different from the implementer of financial safety and soundness standards."[114]

Both Treasury and the GAO referred to the history of financial regulators, such as the Farm Credit Administration before 1985, and the Federal Home Loan Bank Board, and the problems that can beset a federal agency or department when it has conflicting responsibilities that include supervision or promotion of the programmatic benefits delivered by the regulated institution and also of the institution's financial safety and soundness. Each recommended that the programmatic regulator continue to supervise the benefits of enterprise activities, but that a separate regulator oversee enterprise safety and soundness.

### 2. Centralizing Financial Supervision of all Enterprises in a Single Agency

In testimony, Treasury Undersecretary Robert Glauber pointed to the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC) or the Treasury itself as suitable locations for the function of supervising enterprise safety and soundness. Regulation of safety and soundness of all government sponsored enterprises would thereby be centralized within a single federal agency. Issues involving the allocation of enterprise benefits, such as the questions involving the extent that they should be permitted to engage in new kinds of activities, would be left to Congress, or to the appropriate executive department oversight agency, such as the Department of Housing and Urban Development.

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[113] Statement of Richard L. Fogel, Assistant Comptroller General, "Risks and Oversight of Government Sponsored Enterprises," Testimony Before the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, p. 11.

[114] *1990 Report of the Secretary of the Treasury and Government Sponsored Enterprises*, p. 10.

The Treasury's 1990 recommendation (changed in 1991, as noted below) raises some institutional issues. If the financial regulator were located in the Treasury Department, it could be structured as a distinct office similar to the Office of the Comptroller of the Currency, or the recently created Office of Thrift Supervision. Alternatively, similar to the Federal Deposit Insurance Corporation, the centralized regulator might be structured as an independent agency responsible for supervising safety and soundness of all enterprises.

The centralized regulator would develop long-term expertise in assessing and regulating financial soundness of the enterprises. Especially important, the regulator could apply lessons learned from one government sponsored enterprise in overseeing the others and in providing guidance to Congress about structuring proposed new enterprises. The enterprises would no longer be treated as unique financial institutions, embodying public and private characteristics capable of engendering considerable confusion among federal policymakers.

There are arguments against centralized regulation of the various enterprises. Traditional constituencies of the enterprises are concerned about the consequences of such regulation, even if it is limited to considerations of financial soundness. For example, Henry Schechter, then Director of the AFL-CIO Office of Housing and Monetary Policy, contended that,

> "There would be a loss of sympathetic understanding for the various types of financing programs to meet housing and other special needs, and perhaps prejudice toward greater restrictiveness than is necessary to avoid excessive risks."[115]

Similarly, supporters of Farm Credit System institutions point out that regulation of their unique cooperative structure requires a special sensitivity to the significant differences between cooperative principles and operations and those of traditional profit-oriented corporations. Sallie Mae and its supporters are likely to oppose subjecting that corporation to any supervision at all, especially given Sallie Mae's tradition of exceptional financial soundness. Finally, it can be argued that a centralized regulator would lack necessary knowledge of the specialized markets for mortgages and farm credit now found in HUD and the FCA.

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[115] Henry B. Schechter, personal communication to the author, May 12, 1987.

There are political reasons why centralizing the regulation of enterprises may not succeed. Some congressional committees fear partial loss of authority over enterprises now completely within their jurisdiction. As an alternative to centralized regulation of the financial soundness of all of the enterprises, the Congress might attempt to fashion a common regulatory structure for each enterprise under capable individual regulators. This, however, would make them even more prone to regulatory capture than would be the case for a centralized financial regulator.

## E. The 1991 Treasury, General Accounting Office, and Congressional Budget Office Reports

In late April 1991, the Treasury Department released its *1991 Report of the Secretary of the Treasury on Government Sponsored Enterprises* and the Congressional Budget Office (CBO) released its report, *Controlling the Risks of Government-Sponsored Enterprises*. In May 1991, the U.S. General Accounting Office Release its report, *Government Sponsored Enterprises: A Framework for Limiting the Government's Exposure to Risks*. In testimony before several committees during May 1991, representatives of the Treasury, GAO, and CBO presented their recommendations and findings to the Congress.

### 1. The 1991 Treasury Department Recommendations

In three significant respects, the Treasury Department revised its recommendations from its 1990 report and testimony. First, in 1990 the Treasury had recommended centralizing safety and soundness regulation of all government sponsored enterprises within a single institution; the 1991 recommendation was to strengthen existing regulators and to empower the Treasury itself to oversee safety and soundness of Sallie Mae. Second, in 1990 the Treasury had recommended using ratings from private rating companies as the basis for setting capital standards; in 1991 the Treasury decided to leave authority to set and enforce capital standards with each enterprise regulator. The ratings would be available as an analytic tool to assist a regulator in assessing the financial condition of a government sponsored enterprise, but would not be determinative in setting capital standards. One exception to this new approach was the 1991 Treasury recommendation that any enterprise receiving the highest "AAA" rating would be permitted a statutory "safe harbor"--an exemption from most regulatory requirements, including capital requirements. Third, in 1990 the Treasury had proposed relying upon private rating companies as the primary basis for federal supervision of each enterprise; in 1991, the Treasury recommended a panoply of enforcement powers based upon those of the federal bank regulators. Tables 7, 8, and 9 show the limited differences between the FDIC, as a federal bank regulator, and the Treasury recommendations for each enterprise regulator with respect to institutional capacity, supervisory authority, and enforcement powers.

In making its recommendation that existing enterprise regulators continue to have authority to regulate safety and soundness, the Treasury Department did direct attention to the problem of regulatory capture:

> "The Treasury Department is under no illusions concerning the capture problem. No regulatory structure can ensure that it will not happen. Continued recognition of the importance of ensuring prudent management of the GSEs and vigilance in this regard by both the executive and legislative branches will be necessary."[116]

To address the problem of regulatory capture, the Treasury recommended that the Department of Housing and Urban Development establish a separate "arm's length" bureau. The director of the new bureau would be appointed by the President and confirmed by the Senate, and would be removable only by the President. Moreover, financial safety and soundness oversight of Fannie Mae and Freddie Mac would be given primacy over other regulatory goals. Similarly, the Federal Housing Finance Board would retain financial oversight of the Federal Home Loan Banks. However, its statute would be amended to make financial safety and soundness of the Federal Home Loan Banks the primary regulatory goal of the FHFB. The Treasury recommended that the Farm Credit Administration retain financial oversight over the Farm Credit System and Farmer Mac. However, the FCA's financial oversight over Farmer Mac, particularly with respect to authority to set capital standards, would be increased. Also, the Farm Credit System Insurance Corporation would be given access to the capital of Farm Credit System associations. Finally, the Treasury would receive oversight authority with respect to Sallie Mae, consistent with the safety and soundness authority provided for the other regulators.

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[116] Statement of Robert R. Glauber, Under Secretary of the Treasury for Finance, Before the Senate Committee on Banking, Housing, and Urban Affairs, May 10, 1991, p. 5 (Typewritten text).

## 2. The 1991 General Accounting Office Recommendations

In its 1991 Report and Testimony, the U.S. General Accounting Office remained somewhat more consistent with its 1990 recommendations. The GAO recommended that Congress establish a new federal regulatory structure to oversee each goverment sponsored enterprise, establish reasonable capital rules based on risks undertaken by the enterprises, and provide the enterprise regulator with appropriate enforcement authorities.

The GAO proposed creation of a single regulator, tentatively called the Federal Enterprise Regulatory Board. The Board would have three voting members, a full-time chairperson appointed by the President, the Secretary of the Treasury, and the Chair of the Federal Reserve System. The chairperson would serve a fixed-length term and be an individual familiar with government with a respected record of achievement. To provide advice on specific agriculture, education, and housing programs and markets, the Board would also include three nonvoting members--the Secretaries of Agriculture, Education, and HUD. The GAO recommended that the three secretaries have nonvoting status to "protect the arm's-length nature of the Board by minimizing the possibility that these members use the GSEs to address public concerns not envisioned by GSE charters."[117]

Second, the GAO recommended that the government sponsored enterprises, except for the Farm Credit System, be subject to minimum capital standards based on the sum of (1) empirically-based measurements of the capital needed to withstand credit risk and interest rate risk losses in stressful economic environments (so-called stress tests), and (2) an amount equal to a proportion of an enterprise's obligations, both on- and off-balance sheet, so that capital is held for management, operations and business risks. The regulator would have discretion to adjust the required minimum capital standards as markets, technologies, and enterprise operations evolved. Farm Credit System banks would continue to have capital requirements patterned after bank-risk based capital rules.

Thirdly, the GAO recommended that the new enterprise regulator have appropriate enforcement authorities; Tables 7, 8, and 9 summarize the recommendations of the draft GAO report in this regard.

Finally, the GAO recommended that the regulator use notice-and-comment rulemaking to issue regulations regarding Safety and Soundness. These "rules should define regulatory expectations in sufficient detail to enable the GSE to determine the regulatory consequences of its business decisions."[118]

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[117] Statement of Harry S. Havens, Assistant Comptroller General, Before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, May 10, 1991, "Improved Regulatory Structure And Minimum Capital Standards Are Needed For Government Sponsored Enterprises," p. 6 (Typewritten text).

## 3. The 1991 Congressional Budget Office Report

The Congressional Budget Office did not make specific policy recommendations in its report. Instead, the CBO presented policy options and noted their advantages and disadvantages. The Congressional Budget Office did use the bank and thrift model of supervision as the starting point for making its policy recommendations, and identified various ways to adapt that model to government sponsored enterprises. In particular, the CBO proposed use of a streamlined system of supervision for enterprises with low risk profiles. Tables 7, 8, and 9 summarize the policy options of the Congressional Budget Office with respect to the institutional capacity, supervisory authority and enforcement powers that should be given to federal regulators of enterprise safety and soundness.

With respect to institutional structure, the CBO identified two principal options. One would be to centralize responsibility in a new federal agency with an independent board (essentially comparable to the 1991 recommendation of the General Accounting Office). An alternative option would be to move supervision and program regulation of Fannie Mae and Freddie Mac from HUD to the Federal Housing Finance Board that oversees the Federal Home Home Bank System today. The FHFB would be given the general institutional structure, supervisory authority, and enforcement powers of a federal bank regulator with some modifications, and would be responsible for supervising the three housing-related government sponsored enterprises.

The CBO also addressed the issue of setting capital requirements. It presented as one policy option the possibility that the Congress would establish a statutory minimum capital requirement to protect the government against an enterprise's exposure to management and operations risk; alternatively, this authority could be delegated to the federal supervisory agency. The CBO also discussed the possibility of allowing an enterprise to reach a "safe harbor" from federal capital requirements if two credit rating companies gave its securities an exceptionally high rating without regard to the government's implicit backing.

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[118] U.S. General Accounting Office, *Government-sponsored Enterprises: A Framework for Limiting the Government's Exposure to Rights* (May, 1991), p.34

## Table 7
### *Institutional Capacity: The 1991 Reports*

| Regulator | Sources of Funds | Executive Branch Control of Budget | Sets Own Staffing Ceilings | Sets Own Salary Schedules Comparable to Bank Regulatory Agencies |
|---|---|---|---|---|
| FDIC | Assessments on Regulated Institutions 12 USC §1817 | No - OMB Circular A-11, §11.2 | Yes | Yes, 12 USC §1833b |
| 1991 Report | | | | |
| CBO[*] | Yes | No | Yes | Perhaps Pay More Than Bank Regulators |
| GAO (Preliminary) | Yes | No | Yes | Yes |
| Treasury | Yes | No | Yes | Yes |

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[*] Rather than make express recommendations, the CBO study presents arguments for and against various policy options; on balance, CBO's evaluation appears to be as indicated.

## Table 8
*Supervisory Authority: The 1991 Reports*

| Regulator | Prescribe Reports | Examine | Set Binding Capital Requirements | Appoint A Conservator or Receiver |
|---|---|---|---|---|
| FDIC | Yes, 12 USC §1817(a) | Yes, 12 USC §1820(b) | Tesm 12 YSC §3907(a) | Yes, 12 USC §1821 |
| 1991 Report | | | | |
| CBO[*] | Yes | Yes (with possibility of streamlined supervisrion | Yes | Conservator, Yes, Receiver, No |
| GAO (Preliminary) | Yes | Yes | Yes | Conservator, Yes |
| Treasury | Yes | Yes (with possibility of streamlined supervision) | Conservator, Yes Receiver, No | Yes |

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[*] Rather than make express recommendations, the CBO study presents arguments for and against various policy options; on balance, CBO's evaluation appears to be as indicated.

## Table 9
### *Enforcement Powers: The 1991 Reports*

| Regulator | Capital Directives | Issue Cease and Desist Orders | Remove Directors or Officers | Impose Civil Money Penalties | Restrict Dividends | Disapprove Risky Activities |
|---|---|---|---|---|---|---|
| FDIC | Yes, 12 USC §3907(b) | Yes, 12 USC §1818(b)(c)(d) | Yes, 12 USC §1818(e) (f), (g), (h) | 12 USC §1818(i) | Not Directly | Not Directly |
| 1991 Report<br>CBO[*] | Yes | Yes | Yes | No | Not Directly | Not Directly |
| GAO (Preliminary | Yes | Yes | Yes | Yes | Like FDIC | Limit Risk |
| Treasury | Yes | Yes | Yes | Probably | Like FDIC | Yes |

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[*] Rather than make express recommendations, the CBO study presents arguments for and against various policy options; on balance, CBO's evaluation appears to be as indicated.

# VII. Federal Programmatic Oversight of Enterprises and Their Public Purposes

## A. Enterprises and Their Public Purposes

Enterprise benefits consist of the public purposes served by enterprise lending. Depending on its particular structure, an enterprise can use its borrowing advantages to reduce borrowing costs and improve loan terms for homebuyers, farmers, thrift institutions, or other borrowers in its designated market. Many times enterprises are created to serve carefully targeted purposes. Over time, however, a number of enterprises have obtained statutory changes permitting service to a much broader market with less apparent connection to priority credit needs.[119] Controversy over enterprise benefits can become politically-charged, involving the contending interests of varying kinds of borrowers seeking federally-supported credit, enterprise competitors, firms doing business with the enterprises, and the enterprises themselves. Not all claimants for inexpensive federally-supported credit can be accommodated. Indeed, much of the value of federally-supported credit is in the edge it provides borrowers over others (especially competitors) lacking access to such credit.

It turns out that the federal departments and agencies overseeing the performance of public purposes of the enterprises have little, if any, authority to place enterprises into conflict with the requirements of a safety and soundness regulator. None of the program overseers--HUD, the Farm Credit Administration, the Federal Housing Finance Board, or the Department of Education--has a mandate to compel enterprises to act to the detriment of safety and soundness. Thus, the Fannie Mae and Freddie Mac charter acts state that "the Secretary [of Housing and Urban Development] may require that a reasonable proportion of the corporation's mortgage purposes be related to the national goal of providing adequate housing for low and moderate income families, but with reasonable economic return to the corporation." (12 U.S.C. 1723a(h), and 1452(b)(2).) By its plain meaning, a "reasonable economic return" would include a return sufficient to permit the corporation not only to make a reasonable profit, but also to maintain the necessary capital associated with the loans.

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[119] See Thomas H. Stanton, "Government Sponsored Enterprises: Their Benefits and Costs as Instruments of Federal Policy," pp. 12-13 (1988).

Similarly, the Farm Credit Administration does not have programmatic authority that would contradict its safety and soundness responsibilities. Thus, 12 U.S.C. 2207 provides that Farm Credit System institutions shall prepare a program of providing credit and services to "young, beginning, and smaller farmers and ranchers." The relevant Farm Credit Administration regulations, at 12 CFR 614.4165 ("Special Credit Needs"), include the provision that "capital resources with which to withstand risk and staff resources capable of providing specialized servicing shall be major considerations in program development." The Farm Credit Administration is also responsible for assuring that activities of Farm Credit institutions remain within the bounds of the charter act. See 12 U.S.C. 2019 and 2020 and 12 CFR 618.8000, *et seq.* Similar to HUD's authority over Fannie Mae and Freddie Mac, the Farm Credit Administration has no authority to compel FCS institutions to engage in particular kinds of lending.[120]

The role of the Federal Housing Finance Board in overseeing provision of credit to support community investment and affordable housing establishes a useful model for balancing service to a high priority public purpose, on the one hand, with safety and soundness, on the other. See 12 U.S.C. 1430(i) and (j). The FHLBS program, established by the 1989 Financial Institutions Reform, Recovery and Enforcement Act, provides that Federal Home Loan Banks shall set aside a specified amount of money to support community investment and low income housing. The statutory scheme enables the Federal Housing Finance Board, in contrast to HUD and its powers over Fannie Mae and Freddie Mac, to require that Federal Home Loan Banks offer interest subsidies and other support to low income and community borrowers. However, the law carefully circumscribes the financial risks and any potential impact on safety and soundness by specifying limits to the aggregate amount of the subsidy to be provided by the FHLBS.

Finally, the Department of Education has no regulatory authority over Sallie Mae with respect to safety and soundness or Sallie Mae's performance of its public purposes.

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[120] Indeed, the Farm Credit System went through a very unhappy period from 1939 to 1953 when the FCA was a part of the U.S. Department of Agriculture. This period was marked by considerable controversy because the Department of Agriculture, similar to the Department of Housing and Urban Development in the late 1970s, sought to impose external programmatic objectives onto the government sponsored enterprise that it regulated. See W. Gifford Hoag, *The Farm Credit System: A History of Financial Self-Help*, 1976, pp. 196-198 and 249-256.

## B. Congressional Oversight of the Way That Enterprise Serves Their Public Purposes

Creation of an enterprise results from a political process and later congressional changes in the scope of enterprise activities (i.e., allocating benefits) can involve the politics of contending interests. In 1983-84, for example, Fannie Mae sought congressional approval to expand its mortgage lending powers. The request precipitated a legislative confrontation among Fannie Mae's competitors (including Freddie Mac), lenders doing business with Fannie Mae, and the real estate industry. The Reagan Administration also joined the fray, advancing arguments on behalf of its government-wide opposition to expansion of federally-supported credit. Congress rejected much of the Fannie Mae request, in large part due to the opposition of companies active in the markets Fannie Mae proposed to enter.[121]

In short, the issue of allocating enterprise benefits, and reallocating those benefits, can be highly charged politically. The scope of authorized enterprise activities reflects a balance of power among interested constituencies, many of whom are close to the congressional authorizing committees responsible for enterprise legislation.

The issue of enterprise benefits tends to be too much for a federal agency to handle without congressional direction. Two recent cases come to mind. In 1987, the Federal Home Loan Bank Board tried to limit Freddie Mac to a $75 billion annual level of loan purchases. Even though many in the thrift industry supported this measure, Congress decisively rejected the FHLBB action and enacted legislation precluding the regulator from imposing such ceilings.[122] By the end of 1987, Freddie Mac exceeded the fairly generous FHLBB ceiling and continued its rapid growth. Today, Freddie Mac has over $300 billion in mortgage-backed securities outstanding, and is larger in its lending activities than any major money center bank in the United States.

Another major example concerns Fannie Mae and its regulator, the U.S. Department of Housing and Urban Development (HUD). In the late 1970s, HUD demanded that Fannie Mae increase its support of low-income homebuyers in central cities. In 1978, the Department proposed regulations requiring Fannie Mae to direct at least 30 percent of its mortgage purchases to housing for low- and moderate-income families, and 30 percent of its commitments to mortgages on properties in central cities. In the face of intense industry opposition, HUD rescinded its proposed regulatory requirements. As the regulator noted:

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[121] See e.g., *Legislative Proposals Concerning FNMA and FHLMC: Hearings before the Subcommittee on Housing and Community Development of the House Committee on Banking, Finance and Urban Affairs*, (May 17-18, 1983).

[122] 12 U.S.C. 1454(c).

> "HUD received 1,233 comments on the proposed regulations. Of these, all but 16 were negative. The opponents of the regulations included more than a dozen national industry trade associations, many individual members of Congress, the congressional rural caucus (140 members), and many local and regional trade associations."[123]

* * * *

> "...with the help of numerous supporters, FNMA thwarted HUD's efforts to channel the corporation's activities towards greater support for low- and moderate-income housing and housing in older urban areas. [D]uring this period, in the mid-to-late 1970s when FNMA's financial security did not seem to be threatened, the Department tried but failed to channel FNMA'S activities into specific areas of public policy concerns."[124]

Since the late 1970s, Congress has removed several powers that had been available to HUD in its controversy with Fannie Mae. While counterexamples can be found of a regulator successfully redirecting enterprise benefits to some extent, the basic point remains: for any significant change in allocation of enterprise benefits, it is rare that an administrative agency can succeed without congressional backing. This conclusion is bolstered by a practical consideration. Many details of the scope of enterprise authority are spelled out in the enabling legislation so that significant redirection of enterprise benefits will tend to require congressional involvement in any event. An agency's role in this regard would be limited to assuring that an enterprise properly observes the legal limits imposed by Congress and does not engage in ultra vires acts.[125] While matters of safety and soundness might be delegated, congressional committees like to keep the allocation of benefits to themselves.

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[123] U.S. Department of Housing and Urban Development, *Analysis of the Development of the Regulations Governing the Operations of the Federal National Mortgage Association*, cited in U.S. Department of Housing and Urban Development, *1986 Report to Congress on the Federal National Mortgage Association*, p. 166 (1987).

[124] *1986 Report to Congress, Ibid.*

[125] For government sponsored enterprises, ultra vires acts may not be subject to correction by shareholder litigation or other judicial intervention. See e.g., *First American Federal Savings and Loan Assn., et al. v. Student Loan Marketing Assn.*, No. 84-1014-Civ-5 (E.D.N.C., 1985).

## C. Enhancing Congressional Oversight of Enterprise Public Purposes

Even though the ultimate decision about the allocation of enterprise benefits rests with Congress, responsible agency or departmental support can contribute considerably to the quality of congressional oversight. The technical details of enterprise charter acts are arcane and susceptible to misunderstanding by any but the most experienced practitioners in the field. A knowledgeable regulator can assist members of Congress to make informed decisions. Too often misinformation prevails. For example, the House of Representatives in 1986 passed a bill to create a new enterprise, the Corporation for Small Business Investment (COSBI). Buried in that bill was a provision permitting COSBI to act "without regard to any other law," except as Congress expressly applied such laws to the COSBI charter act.[126] It is unlikely that members of Congress understood that they were voting to create a corporation that would arguably be exempt from civil and even criminal laws everyone else would be required to obey. Proponents of the bill told congressional staff the complicated provision was mere technical "boiler plate." On this understanding, leading members of the House and Senate introduced the bill several times over several years with that language included.

Congressional committees would especially benefit from technical analysis and recommendations concerning the structure of the federal legislation governing an enterprise. The legislative structure can profoundly affect the way an enterprise allocates its benefits and the extent it passes on its borrowing advantages by lending at favorable rates to its customers. Congress also needs to oversee the allocation of enterprise benefits as markets change over time. Benefits provided by an enterprise under its charter legislation should be evaluated periodically in terms of (1) the degree that it passes on its borrowing advantages to ultimate borrowers, rather than keeping the benefits for shareholders, and (2) the degree that its benefits flow to borrowers with the highest priority credit needs.

Today's enterprises differ significantly in these two respects. Because of the structure of the federal guaranteed student loan program and because of its own pricing policies, Sallie Mae passes on virtually none of its borrowing advantages and tax benefits to students in the form of lowered interest rates on student loans. Instead, its benefits accrue almost exclusively to the corporate

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(Neither Sallie Mae shareholders nor competitors have a private cause of action to enjoin allegedly ultra vires acts).

[126] H.R. 5300, 99th Cong., 2d. Sess., Omnibus Budget Reconciliation Act of 1986, Section 9010, passed by the House of Representatives, September 24, 1986.

shareholders.[127] At the other extreme, the Farm Credit System banks have engaged in overly generous loan pricing during certain periods in the past, and have actually passed to borrowers greater benefits than the FCS could afford to sustain.

The enterprises also differ significantly in the degree to which they meet the highest priority credit needs. Congress generally begins by trying to target the benefits of enterprise activities to meet specific perceived public priorities. Over time, as markets and policies change, and as enterprises seek to expand their permitted activities, Congress tends to react by expanding the statutory purposes.

Again, Sallie Mae stands at one extreme. Originally established to provide a secondary market for guaranteed student loans, Sallie Mae has used its statutory authority as the basis for making large-scale advances of funds, collateralized by home equity loans, to financial institutions. Not only are most home equity loans unrelated to credit needs of most students, but the financial institutions may use the advances to support virtually any authorized lending activities, ranging from foreign loans to industrial loans.

Besides its broad express powers, Sallie Mae is authorized "to undertake any...activity the Board of Directors of the Association determines to be in furtherance of the programs of insured student loans [or uninsured student loans] authorized under this part or will otherwise support the credit needs of students."[128] This is a much broader provision than is provided for the other enterprises or even for other federally chartered financial institutions.[129]

Questions of public purpose are among the most difficult to address for government sponsored enterprises. The continuing question for Congress is whether the benefits of an enterprise, in terms of public purposes actually served, are targeted to the most deserving borrowers from among the many who could make a claim for federally supported credit. Other public purpose questions arise from the peculiar characteristics of government sponsored enterprises. To what extent is an enterprise the best instrument to serve public purposes Congress considers important? Even if Congress is free legally,[130] to what extent is it free politically to confine or redirect the public purposes served by an enterprise if this would adversely affect the investment of enterprise shareholders?

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[127] See e.g., Barry Bosworth, Andrew Carron and Elisabeth Rhyne, *The Economics of Federal Credit Programs*, The Brookings Institution, pp. 146-47 (1987).

[128] 20 U.S.C. 1087-2(d)(1)(E). In 1986, Congress amended the law to prohibit Sallie Mae from owning or operating a depository institution. 20 U.S.C. 1087-2(d)(1)(E)(ii).

[129] Fannie Mae, for example, is limited to its express powers plus authority "to do all things as are necessary or incidental to the proper management of its affairs and the proper conduct of its business." 12 U.S.C. 1723a(a). National banks are limited to express powers plus "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. 24 (Seventh). By contrast to the confining court interpretations of such incidental power provisions, the broad grant of authority to Sallie Mae is breathtaking.

Congressional oversight would be helped immensely if the responsible congressional committees required the relevant administrative agency or executive department to prepare an annual report of the allocation of benefits of enterprise activities and recommendations for improvement. Given the proverbial tendency of regulators to be captured by the regulated institutions, such a report might preferably be generated by a central source with analytic capabilities such as the Congressional Budget Office or the Treasury Department.[131]

In summary then, federal control of enterprise benefits is best left to congressional oversight committees with analytic support from the appropriate agencies or departments. By contrast, the limited function of supervising safety and soundness is best delegated to an administrative agency with the resources and statutory mandate to do a good job.

## VIII. Conclusion

The case for imposing effective financial regulation is strong. The example of hundreds of failed thrift institutions looms before us, along with conclusive evidence that the problem was greatly magnified by the government's failure effectively to regulate financial safety and soundness. The recent financial breakdown of the Farm Credit System also provides evidence of regulatory shortcomings that contributed to taxpayer losses.

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[130] See *Union Pacific Railroad Co. v. U.S. (Sinking Fund Cases)*, 99 U.S. 700 (1878) (Congress reserves authority to amend the federal charter of a corporation to alter the rights, privileges or immunities it has granted by that charter); *Fahey v. O'Melveny & Myers*, 200 F.2d 420 (9th Cir. 1952).

[131] The congressional consideration of benefits and costs of enterprise operations might also be enhanced by including a long-term sunset provision in each enterprise charter act. While the length of the term is ultimately a political judgment for the Congress to make, a 20-year sunset, as was provided in the charters of the first and second Banks of the United States, would seem to be close to an appropriate length of time. "An Act to Incorporate the Subscribers to the Bank of the United States," Sec. 3, Approved February 25, 1791, 1 Statutes at large, 191; "An Act to Incorporate the Subscribers to the Bank of the United States," Sec. 7, Approved April 10, 1816, 3 Statutes at large, 266.

Twenty years is long enough to permit an enterprise to lend billions of dollars to its directed beneficiaries, but short enough to permit in-depth congressional review of the inevitable political and economic changes over that period of time. To avoid disrupting the capital markets, such a sunset provision might provide for converting enterprise obligations into full-faith-and-credit obligations of the United States if the charter were not renewed.

Unfortunately, regulatory lapses are not accidental. Indeed, they reflect a serious dynamic that must be overcome to implement the proposals presented above. The dynamic evolves as follows: When times are good and financial institutions profitable, Congress and the Executive Branch perceive no special need to apply stringent regulation of safety and soundness. "If it ain't broke, don't fix it," is a potent piece of conventional wisdom. Calls for strict regulation tend to come only after something goes wrong.

By then, of course, it may be too late. Given the volume of enterprise activity, literally billions of dollars of mistakes may have been made before problems come to light. Consider the evolution of the perceived state of the Farm Credit System over only 4 years. Until 1982, the Farm Credit System was viewed as a premiere government sponsored enterprise. It spent much of that year rebutting efforts of the Reagan Administration to remove its implicit federal guarantee and make the FCS into a fully self-supporting institution in the private sector. In 1983, the Farm Credit Administration did report on some loan losses, but noted that "overall these loan losses represent a small percentage of the loans outstanding." In 1984 the FCA reported financial stress, but explained that "despite this stress the system was able to cover its losses in 1984 and remains financially sound." In 1985 the Farm Credit Administration and FCS called upon Congress for financial help; the system reported a $2.7 billion loss for the year. In 1986, the FCS reported an additional $1.9 billion in losses, and in 1987 Congress provided up to $4 billion to bail out the system.[132]

After the FCA announced the pending FCS insolvency, Congress began to insist on more strict regulation to curb FCS losses. By then it was too late for a ranking agriculture committee member to ask the FCS regulator, "As the Governor - and I guess the buck stops at your desk in this organization - why didn't you do something about unsafe and unsound banking practices?"[133]

If it is unappealing to impose effective regulation in good times, circumstances can also be adverse in bad times. When bad times hit, the damage may already be done. Much attention then shifts to the plight of the people and institutions that may be in trouble along with the failed financial institution. Especially if borrower defaults or delinquencies are involved, considerable pressure can be brought to bear on the regulator to forebear from forcing foreclosure on the loans. As desperate farm borrowers contacted their members of Congress, borrower relief became a major theme in the 1987 Farm Credit legislation.[134]

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[132] Farm Credit Administration, *1983 Annual Report*, at p. 2; *1984 Annual Report*, at p. 1.; *1985 Annual Report*, at pp. 2, 21, *1986 Annual Report*, at p. 23.

[133] *Agricultural Credit Conditions, Hearings before the Subcommittee on Conservation, Credit, and Rural Development of the House Committee on Agriculture*, at p. 343 (October 30, 1985).

Such pressure for lenience was also apparent in federal efforts to deal with thrift institution insolvencies.[135] Indeed, with congressional support, the FHLBB significantly reduced its capital requirements in the early 1980s to accommodate thrifts in financial difficulty. While this strategem permitted the regulator to avoid applying enforcement measures against many troubled thrifts, it permitted continuation and even acceleration of poor financial practices by literally hundreds of insolvent institutions. Especially because bad times can mean that considerable financial mismanagement or misjudgment has already occurred, action to impose financial discipline after-the-fact tends to come too late to forestall harm.

Thus, there are compelling practical reasons to justify effective regulation of financial soundness. There is an opportunity now to learn from past regulatory failures and impose regulation of safety and soundness, before another enterprise gets into trouble. In today's unusual economic environment, financial viability is an essential goal for any financial institution or federal credit program. With signs of weakness in government credit programs and in private institutions includng record numbers of failing banks and thrifts, safety and soundness cannot be presumed.

Congressional committees should keep for themselves the power to allocate benefits from enterprise lending, but they will serve themselves and their constituencies by delegating effective financial regulation to a hard-nosed, politically independent regulatory agency and by imposing meaningful capital requirements. That is far wiser than risking the need to stand over the ruins of a once proud financial institution and ask a weak regulator, "Why didn't you regulate safety and soundness?"

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[134] See e.g., "Farm Credit System Under Orders To Get Tough, Is Hampered By Lawmaker Pleas for Leniency," *Wall Street Journal*, (May 29, 1986) p. 34. H. Con. Res. 310, 99th Cong. 2d Sess. ("To Express the Sense of Congress with Respect to Agricultural Loan Restructuring and Interest Rates") passed the House May 14, 1986; S. Con. Res. 138, 99th Cong. 2d Sess. (1986), ("Expressing the Sense of the Congress with Respect to Farm Credit System Agricultural Loan Restructuring"), was introduced in the Senate the same day with 61 cosponsors. Section 102 of the Agricultural Credit Act of 1987, Pub. L. No. 100-233, calls upon FCS institutions to restructure rather than foreclose on distressed farm loans.

[135] See e.g., *Congressional Record*, at pp. H3149-H3165 (daily edition May 5, 1987). Title IV of the Competitive Equality Banking Act of 1987, Pub. L. No. 100-86, called for the FHLBB to forebear in closing insolvent thrift institutions.

## Report for Recommendation 91-7

# The Farmer-Lender Mediation Program: Implementation by the Farmers Home Administration

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This report was prepared for the consideration of the Administrative Conference of the United States. The views expressed are those of the author and do not necessarily reflect those of the members of the Conference or its committees except where formal recommendations of the Conference are cited.

## Preface

This is a study of how the Farmers Home Administration (FmHA), an agency of the U.S. Department of Agriculture, implemented a program--mandated by Title V of the Agricultural Credit Act of 1987[1]--to mediate delinquent farm loans. I hope that this report will be useful, first, to persons and agencies involved in the farmer-lender mediation program, and second, to government officials charged with implementing the Administrative Dispute Resolution Act of 1990[2], which may portend a vast expansion in the use of alternative methods of dispute resolution (ADR) by federal agencies, and persons responsible for implementing the Civil Justice Reform Act of 1990, which provides encouragement and authorization for federal district courts to use alternative methods of dispute resolution.[3]

In preparing this study, I have tried to avoid excessive detail about the FmHA loan programs or the FmHA's implementation of the farmer-lender mediation program, and this for two reasons. First, this program was large and diverse, including thousands of mediations conducted by hundreds of mediators in at least 30 states. Seventeen of these states created mediation programs for which the FmHA provided matching funds. In more than a dozen other states, the FmHA arranged for mediation services through contracts. In some states FmHA used its own employees to conduct "voluntary meetings of creditors." The circumstances facing mediation participants varied not only state-to-state but also by region within states and by time periods. Every farm family had its unique set of personalities and circumstances--legal, economic, social, psychological and interpersonal--and so did every mediator and every lender. Moreover, the mediations often were set in an elaborately complex system of loans and loan servicing options. Accordingly, it seemed impossible to describe or analyze this program in any detailed way.

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[1] Agricultural Credit Act of 1987, §§501-512, 7 U.S.C. §§5101-5106, 2006; 12 U.S.C. §2202e (1988).

[2] The Administrative Dispute Resolution Act of 1990, Pub. L. No. 101-552, 104 Stat. 2736 (1990) requires each federal agency to develop a policy on the use of alternative dispute resolution, and, in doing so, to examine the use of such methods in: (A) formal and informal adjudications; (B) rulemakings; (C) enforcement actions; (D) issuing and revoking licenses or permits; (E) contract administration; (F) litigation brought by or against the agency; and (G) other agency actions. In addition, each agency must name a "senior official to be the dispute resolution specialist of the agency," and provide training in dispute resolution for such person and for other agency officials who will be involved in implementing the policy. The Act requires every agency to consider amending its standard agreements to deal with alternative dispute resolution, and mandates the appropriate amendment of the "Federal Acquisition Regulation." The statute also amends the Administrative Procedure Act in several ways to facilitate agency use of alternative methods of dispute resolution. It authorizes agencies generally to use ADR to resolve an issue in controversy if the parties agree, and provides that the Administrative Conference will establish standards for neutrals, maintain a roster of neutrals, enter into contracts for services of neutrals that may be used by agencies, and develop procedures that would allow agencies quickly to procure services of neutrals. In addition, it authorizes agencies to submit to arbitration, a reversal of a long-standing prohibition. The Negotiated Rulemaking Act of 1990, Pub. L. No. 101-648, 104 Stat. 4969 (1990), encourages agencies to use negotiated rulemaking and establishes procedures for such processes.

[3] Civil Justice Reform Act of 1990, Pub. L. No. 101-650, §102.5D, 104 Stat. 5089, 5090 (1990).

Second, a more detailed report--though it might have been useful to a small number of officials concerned with the program under study or very similar programs--would be of limited interest and utility to other officials charged with carrying out different kinds of dispute resolution efforts.

Therefore, I have attempted to provide just enough texture for the reader to understand the program and its implementation, and to discuss a few issues that seem to pervade the program, most of which will be implicated in other government efforts related to mediation or other alternative methods of dispute resolution.

I am grateful to many people and organizations for help in preparing this study. The Coalition of Agricultural Mediation Programs (CAMP) permitted me to attend three of its national meetings and to use the group and the meetings to develop my own understanding of the farmer-lender mediation program. I also thank those who allowed me to interview them, many of whom also supplied me with written information: Roger Allison, Director, Missouri Rural Crisis Center, Columbia, Missouri; Chester A. Bailey, Assistant to the Assistant FmHA Administrator, Farmer Programs; Frank Blechman, Associate, The Conflict Clinic, Inc. at George Mason University; Gary Condra, Director, Texas Agricultural Loan Mediation Program; Carolyn Crowe, Director, United States Arbitration and Mediation Midwest, Inc., St. Louis, Missouri; Jack Dawson, Director, Conflict Resolution Resources, Boulder, Colorado; Robert Freidenbach, graduate student, Department of Social Behavior, University of South Dakota, Vermillion, South Dakota; Robert Heatherly, Contract Program Manager, FmHA State Office, Nashville, Tennessee; Benne Straughn Herbert, Jr., President, Arbitration and Mediation Services, Cleveland, Ohio; Joanne Katz, farm-credit mediator in Kansas; Lue Lockridge, Contract Specialist, FmHA State Office, Columbia, Missouri; Kathy Mangum, Program Director, Farm Credit Mediation, University of Minnesota Extension Service; Kathy Ozer, National Coalition for Farm Families, Washington, DC; Don F. Reynolds, Chairman and President, Rural Assistance Corporation, Shawnee Mission, Kansas; Lawrence J. Robertson, mediator, U.S. Arbitration and Mediation Midwest, Inc., St. Louis, Missouri;

Richard Routman, President of Farm and Ranch Mediation Services, a division of the Rural Assistance Corporation of Kansas and Director, Midwest Arbitration and Mediation, Inc., Kansas City, Missouri; Kathleen Severens, Coordinator, Nebraska Mediation Service, Walthill, Nebraska; Judge Laurie Smith, mediator, U.S. Arbitration and Mediation Midwest, Inc., St. Louis, Missouri; Ted W. Spiegel, President, United States Arbitration and Mediation Midsouth, Inc., Louisville, Kentucky; James Stovall, Jr., State Coordinator, Oklahoma Agriculture Mediation Program; Peter J.B. Swanson, ADR Coordinator, Federal Mediation and Conciliation Service; and Micheal Thompson, Executive Director, Iowa Mediation Service, Inc.

Professor Peter W. Salsich, Jr. of St. Louis University School of Law and Dennis P. McGilligan, Coordinator, Wisconsin Farm Mediation and Arbitration Program, as well as several persons mentioned above: Frank Blechman, Richard Routman, and Benne Straughn Herbert made written comments on my Preliminary Report, which I greatly appreciate.

I also thank Charles Pou, Jr. of the Administrative Conference for inviting me to undertake this study and for his comments on several drafts. And I am grateful to Deborah Doxsee, Associate Director, Center for the Study of Dispute Resolution, and Micheal Thompson of the Iowa Mediation Service for comments on a draft of this report.

Special thanks to Earl Fraser, '92, University of Missouri-Columbia School of Law for research assistance, and to Laura Crane for word-processing.

# I. Background

## A. The Farmers Home Administration

The FmHA is the successor to the Resettlement Administration, which was created in 1935, and the Farm Security Administration.[4] Its "current mission statement...directs [it] to '"serve as a temporary source of supervised credit and technical support for rural Americans for improving their farming enterprises, housing conditions, community facilities, and other business endeavors until they are able to qualify for private sector resources.'"[5] The Agency's 11,558 full time employees operate numerous loan programs through

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[4] Farmers Home Administration, U.S. Department of Agriculture, A Brief History of the Farmers Home Administration 4-5 (1990) (hereinafter, "Brief History").

[5] Id. at 1. See also 7 CFR Pt. 2003, Subpt. A, Exh. A, 6 (1991).

46 state offices, 264 district offices and 1,904 county offices.[6] The agency often is called a "lender of last resort" because it generally makes loans to persons who can secure no other financing.[7]

## B. The Farm Crisis

The farm sector enjoyed a boom in the 1970s. In 1972-73 farm income rose greatly.[8] Because of the widespread expectation that income would continue to climb, the price of farmland increased dramatically. As a result, many farmers borrowed to purchase machinery and to develop their land,[9] a practice that was highly profitable during boom times.[10] In the early 1980s, however, a rise in interest rates was accompanied by a precipitous decline in the prices of land and machinery. Consequently, many farmers were unable to service their debt, and delinquencies on loans to major farm lenders--principally banks, the Farm Credit System, life insurance companies, and the Farmers Home Administration--grew substantially.[11] Because the FmHA is a lender of last resort,[12] large numbers of farmers who were denied credit assistance by other sources turned to the FmHA for help, and FmHA responded by increasing its portfolio.[13] In the first 6 months of 1985, FmHA made $763 million in new loans to over 7,000 farmers who were technically insolvent. It also made new loans to over 12,000 farmers who had extreme financial difficulties.[14] Because FmHA borrowers tend to be greater risks than other borrowers, and FmHA's delinquencies peaked earlier than those of the other major sources of farm lending. The FmHA was slower than other lenders to liquidate because it is a public entity with a quasi-social function. During each of the years 1980, 1981, and 1982 the FmHA charged off less than $50 million, but the charge-off figures were $.1 billion in 1983 and 1984, $.3 billion in 1985, and $.4 billion in 1985.[15] All four major sources of loans experienced heavy losses.

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[6] Brief History, supra note 4 at 4-5.

[7] Id at 2.

[8] Melichar, Turning the Corner on Troubled Farm Debt, 73 Fed. Reserve Bull. 523, 525-526 (1987).

[9] Id. at 526.

[10] Id. at 527.

[11] Id. at 529.

[12] *See* Curry v. Block, 541 F.Supp. 506, 511 (S.D. Ga. 1982).

[13] U.S. General Accounting Office, Farmers Home Administration: An Overview of Farmer Program Debt, Delinquencies, and Loan Losses (1986). During 1984-86, 50,033 of some 261,000 total FmHA borrowers were considered "continually delinquent" (i.e., delinquent as of June 30 in each of the 3 years). Delinquent payments totalled $6.8 billion. U.S. General Accounting Office, Farmers Home Administration: Loan Servicing Efforts Focus on Continually Delinquent Borrowers (1986).

[14] U.S. General Accounting Office, Farmers Home Administration: Financial and General Characteristics of Farm Loan Program Borrowers (1986).

In the economic downturn afflicting the agricultural sector, FmHA borrowers were hit particularly hard. FmHA, in turn, began to exercise frequently its right to accelerate loans and foreclose on property securing those loans.[16] Borrowers filed numerous lawsuits challenging the FmHA's procedures, with some success.[17] And a widely-seen motion picture, *Country*, starring Jessica Lange and Sam Shepard, dramatized the plight of a family treated roughly by the FmHA.[18]

Accompanying the economic decline in the farm sector was a deterioration in family structures and the social fabric in many rural areas, especially in the midwest. Rates of divorce, child abuse, depression, suicide, and drug abuse escalated, and many rural communities suffered community-wide depression marked by a feeling of hopelessness, exacerbated by a shortage and lack of coordination of social services.[19] A Wyoming rancher put it this way:

> '...imagine, if you can, what it feels like to be losing ranches or businesses that have been three, four, five generations in the making. Reflect on the personal desperation and then try to remember that requesting assistance is seen as that last

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[15] Melichar, supra note 8 at 530.

[16] Numbers of FmHA Farmer Program foreclosures for fiscal years 1982-88 are: 1982, 844; 1983, 615; 1984, 356; 1985, 89; 1986, 111; 1987, 233; 1988, 33. Farmers Home Administration, Selected Farmer Program Statistical Information (May 6, 1988). In 1976, indebtedness to FmHA totalled about $5.5 billion. By 1980, it was over $19 billion, and in 1985 it was over $28 billion.

[17] Allison v. Block, 723 F.2d 631 (8th Cir. 1983); Curry v. Block, 541 F. Supp. 506 (S.D. Ga. 1982); Coleman v. Block, 562 F. Supp. 1353 (D.N.D. 1983); 580 F.Supp. 194 (D.N.D. 1984); 632 F.Supp. 1005 (D.N.D. 1986); 663 F. Supp. 1315 (D.N.D. 1987). See note 40, infra. For a review of some of the practices, see Massey, Farmers in Crisis: A Challenge to Legal Services, Clearinghouse Rev. (November 1984).

[18] Massey, Country: A Good Movie, and True, Clearinghouse Rev. 718 (Nov. 1984). A legal services lawyer wrote that ."..the FmHA practices and procedures are right out of the agency's own regulations. The unilateral freeze and seizure of the Ivy's farm income, cutting them off from family living and farm operating funds; the file notation to 'work toward voluntary liquidation'; the 30-day acceleration/demand letter, and the auction are all specified FmHA procedures. In 1982 and 1983, 15,576 FmHA borrowers who were unable to farm or to fight were put off their farms, many of them through exercise of these practices and procedures." Id.

[19] See National Mental Health Association, Report of the National Action Commission on the Mental Health of Rural Americans (1988).

> measure of defeat, since we have long measured accomplishment in terms of private enterprise and private problem-solving. We continue to believe we must sustain that individual approach in any turmoil or tragedy rather than draw upon any outside strength, especially assistance from human service programs since we are very skeptical of any agency or bureaucracy
>
> ...we are not people who are going to go into mental health centers and fill out forms. We are not people who think of food stamps as an option, or low-income energy programs or public health care provisions
>
> ...what happens to us when we cannot or will not avail ourselves of any of these avenues? Hopelessness and helplessness develop and make for a depression that fosters child and spouse abuse, separation and divorce, alcohol and other drug addiction, violence and suicide.'[20]

## C. Pre-1988 Farmer-Credit Mediation Programs

Iowa and Minnesota responded early to these conditions. The cornerstone of the efforts in both states were mediation programs that have been quite successful and have greatly affected the development of farmer-lender mediation efforts in other states. Although these two programs were created in very different ways, and have very different structures, they share, and have promoted, a common philosophical approach to farmer-lender mediation.[21]

The Minnesota program grew from the work of a task force that was initiated by the Minnesota Department of Agriculture in 1984 and included both public and private agencies that provided services to farmers. It subsequently added bankers, farm advocates, church groups, educators, economists, and farmers.[22] As the crisis deepened, some farm advocates pressed for a 1-year moratorium on foreclosures.[23] In November 1985, bankers agreed at the Governor's request to a voluntary 90-day moratorium on foreclosures on agricultural property[24] and the creation of a farmer-lender mediation program under which the University of Minnesota Extension Service offered farmer-lender mediation to parties who requested it.[25] In short order, the Service located and trained over 300 mediators, and by December 1985 they began to conduct mediations.

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[20] Nedalyn Testolin, Wyoming rancher and founder of Wyoming Rural Support Group, testifying before the National Action Commission on the Mental Health of Rural Americans, National Mental Health Association, Report of the National Action Commission on the Mental Health of Rural Americans 19 (1988).

[21] See Parts III.D.1 & 2, infra.

[22] Blechman, Lessons from the Growth of Farmer-Creditor Mediation Systems, in National Institute for Dispute Resolution Forum 17, 18 (Fall 1990). *See also* Thompson, Crisis in Rural America: The Genesis of Farmer-Lender Mediation, National Institute for Dispute Resolution

During the "moratorium" period, some lenders continued foreclosures.[26] As a result, many legislators viewed the moratorium effort as a failure.[27] In May 1986, the Minnesota legislature, "[i]n a remarkable bipartisan effort,"[28] enacted a statute to address the farm crisis.[29] Among other things, the statute established a farmer-lender mediation program that was "mandatory" in the sense that it prohibited persons from moving to enforce interests in farm property securing debts of more than $5,000 without first serving the debtor with a notice of the availability of mediation.[30] The statute also provided that the creditor may not move against the property until 90 days after the debtor files a mediation request[31] and it required the Agricultural Extension Service[32] to train and provide mediators, as well as credit analysts (to help the farmer prepare for mediation).

The Minnesota legislature appropriated $360,000, for 1 year,[33] and the Agricultural Extension Service moved quickly to provide mediation along with credit analysis services. During the first 6 months, the service handled over

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Forum 3, 3-4 (Fall 1990); Willardson, Alternative Dispute Resolution in Farmer-Lender Disputes: Mandatory Mediation in Minnesota, 5 Law & Inequality 487, 487-491 (1987).

[23] Telephone interview with Kathy Mangum, Farm Credit Mediation Program Director, University of Minnesota Extension Service (Sept. 20, 1990).

[24] Blechman, supra note 22 at 19; telephone interview with Kathy Mangum, Farm Credit Mediation Program Director, University of Minnesota Extension Service (June 26, 1991).

[25] This was part of a 4-H club farm family project and was developed with the assistance of the Minnesota State Office of Mediation, which was funded by the National Institute for Dispute Resolution. Thompson, supra note 22 at 3-4.

[26] Telephone interview with Kathy Mangum, Farm Credit Mediation Program Director, University of Minnesota Extension Service, supra note 23 (June 26, 1991).

[27] Id.

[28] Blechman, supra note 22.

[29] Minn. Stat. §§583.21, 583.32 (1986).

[30] Minn. Stat. §§550.365 (may not attach, levy on, or seize); 559.209 (may not begin to terminate contract for deed); 582.039 (may not begin proceeding to foreclose) (1990).

[31] Minn. Stat. §§583.26(4) - 583.26(5) (1990).

[32] The name of this agency was changed to Minnesota Extension Service in 1987. Telephone interview with Kathy Mangum, supra note 26.

[33] Minnesota Omnibus Farm Bill, 1986 Minn. Laws, Ch. 398, Art. 29, §1(2).

2,000 cases.[34] Since the program's inception, the Minnesota legislature has made annual appropriations for it.[35]

In the first 18 months of the program, it put 645 volunteers through an intensive 2-day training program. Those chosen to participate signed 6-month contracts, which covered out-of-pocket expenses for travel as well as an honorarium of $20 per session.[36] The group includes retired and active farmers, retired bankers, teachers, ministers, and farm financial consultants.[37] The mediation program accepts mediation requests through each of the Extension Services' 87 county offices.[38]

By its terms, the Minnesota statute applies to the FmHA as a creditor.[39] But the FmHA refused to participate in mediations or to restructure loans in connection with mediations.[40] FmHA representatives were available,

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[34] Blechman, supra note 22 at 19.

[35] Telephone interview with Kathy Mangum, supra note 26.

[36] Id. After 3 years, this was raised to $20 for the orientation session (which is a meeting with the debtor) and $30 for each subsequent session.

The program still uses 125 mediators from the original group of trainees. Mediators are evaluated at the end of each 6-month contract and are required to take part in twice yearly inservice training. Id.

[37] See R. Grunke and K. Mangum, Minnesota Extension Service Farm Credit Mediation Annual Report July 1, 1989-June 30, 1990 at 6 (1990).

[38] Id. at 1.

[39] Minn. Stat. §583.24(1) (1990) makes the statute applicable to creditors including "the United States or an agency of the United States."

[40] Telephone interviews with Kathy Mangum (Sept. 20, 1990 and June 26, 1991).

FmHA's reasons for taking this position are not clear. In one case, it argued that the supremacy clause preempted the Minnesota statute. Memorandum in Support of Defendant's Motion for Judgment on the Pleadings, or, in the Alternative, for Summary Judgment at 17, Hansen v. Lyng (D. Minn., 1987). Conventional wisdom is that this was a response to court decisions restricting the FmHA from moving against property that secured its loans unless it followed certain notification and other procedures. Coleman v. Lyng, 580 F. Supp. 192 (D.N.D. 1984), for example, enjoined the FmHA from moving against property of a national class of FmHA borrowers unless it gave the debtor 30 days notice that informs him of his right to contest the proposed action and establish eligibility for loan deferral pursuant to 7 USC §1981a; gives a statement of reasons for the proposed action; informs the borrower of the factors that determine eligibility for loan deferral and of the identity of the person who would preside at the hearing.

In Coleman v. Block, 562 F. Supp 1353 (D.N.D., 1983), a group of North Dakota farmers sought to represent North Dakota farmers holding farmer loan program loans from the FmHA. They claimed that the FmHA had refused to allow farmers to apply for loan deferments, improperly terminated funds for necessary living and operating expenses, and employed biased and unconstitutional appeals processes. In May 1983, the court certified the class and granted a preliminary injunction that enjoined the FmHA from terminating the living and operating allowance or moving to accelerate indebtedness, foreclose, demand voluntary conveyance or however, to meet with FmHA borrowers who were in mediation with other lenders.[41] As a result of the FmHA's refusal to participate, many mediations in both Minnesota and Iowa were frustrated and, according to one commentator, "farmers began filing for bankruptcy because then FmHA would be forced to participate in bankruptcy proceedings."[42]

The Iowa program also began with voluntary mediation, which legislation turned into a program that required farm lenders to participate in mediation requested by borrowers before proceeding against farm property.[43] A broad-based working committee under the leadership of Lieutenant Governor Bob Anderson, with help from the Conflict Clinic, Inc., held forums to discuss mediation. This group rejected the notions of locating the mediation service in a government agency, as had been done in Minnesota, or in a private organization, out of a concern that the providers would appear biased.[44] It decided to create a nonprofit corporation that "represented farmers, creditors,

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repossess chattels until they have given 30 days' notice that: informs the borrower of his right to a hearing to contest the proposed action and establish his eligibility for a loan; gives a statement of reasons for the proposed action; informs of the factors determining eligibility for loan deferral and of the identity of the official before whom the borrower amy request a hearing. It also requires that the hearing officer issue his decision in writing. Id. at 1367-68.

On November 14, the court certified a national class. Coleman v. Block, 580 F. Supp. 192 (D.N.D. 1983). On February 17, 1984, it made the injunction permanent. In response to the court's order, the FmHA promulgated new regulations to implement 7 USC §1981a. 7 CFR §§1924 et seq. These were challenged in Coleman v. Block, 632 F. Supp. 1005 (D.N.D. 1986). There, the court denied most requests for injunctive relief but did enjoin the FmHA to provide an opportunity to appeal to members of the class who disagreed with the amount that the FmHA allocated to living and farm operating expenses.

On May 7, 1987 the same court dismissed a number of plaintiffs' challenges to FmHA practices but also enjoined the FmHA from proceeding against agricultural property of borrowers without giving appropriate notice. It also ordered the FmHA to submit a statement of the true basis and purpose of 7 CFR 1951.44(b)(5), and ordered it to amend Form FmHA 1924-26 by adding "a statement that includes explanations of the various options listed on the form and the effect of choosing one of them are available at the FmHA office" and to amend the form to allow borrowers to make a separate election of options and to include reasons for each proposed FmHA option.

In Coleman v. Lyng, 864 F.2d 604 (8th Cir. 1988), the Eighth Circuit held that the Farm Credit Act of 1987 mooted both the government's appeal and the farmers' cross appeal.

[41] Telephone interview with Kathy Mangum, supra note 26.

[42] Thompson, supra note 22 at 5. *See* Krueger, Mueller & Casey, Farm Credit Mediation Evaluation Report, in Minnesota Extension Service Farm Credit Mediation Program Studies 3, 14 (1986-90).

[43] Iowa Code §654A.6 (1990).

[44] Blechman, supra note 22 at 17.

mediators, attorneys, educators and business executives"[45] to operate the Iowa Farmer-Creditor Mediation Service. The principal goal of the program was to build commitment to the mediation process, rather than seeking specific outcomes, such as keeping farmers on the land.[46]

In the early days of the program, an FmHA employee served on the board of the corporation, and the FmHA participated in mediations until August 1987.[47] At that time, according to Micheal Thompson, Executive Director of the Iowa Mediation Service, the FmHA General Counsel became aware of the discrepancy between FmHA's practices in Iowa and in other states, and called a halt to such participation.[48]

In short order, at least 10 other states began efforts that culminated in the creation of farm-credit mediation services.[49] Many of these efforts were aided by the Conflict Clinic, Inc., which called and facilitated several gatherings of persons concerned with farmer-lender mediation.[50] Most of these programs were voluntary and, perhaps as a result, had lower caseloads, yet many enjoyed settlement rates even higher than those in Iowa and Minnesota.[51]

But the FmHA did not participate.

## D. The Agricultural Credit Act of 1987

In response to these and related events, Congress passed the Agricultural Credit Act of 1987,[52] a massive attempt to deal with problems in the agricultural credit realm. Title V[53] established the program that is the subject of this study. Much of Title VI was intended to respond to court-ordered changes in FmHA's treatment of delinquent borrowers,[54] and it has actually given more rights to FmHA borrowers than was required by the court.[55]

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[45] Thompson, supra note 22 at 4.

[46] Telephone interview with Micheal Thompson, Executive Director, Iowa Mediation Service (July 1, 1991).

[47] Interview with Micheal Thompson, supra note 46.

[48] Id. See note 40, supra.

[49] Alabama, Kansas, Mississippi, Nebraska, North Dakota, Oklahoma, South Dakota, Texas, Wisconsin and Wyoming. Thompson, supra note 22 at 4.

[50] Memorandum from Bill Potapchuk, Conflict Clinic, Inc., to Friends of Farm Debt Mediation. (Oct. 12, 1987).

[51] Thompson, supra note 22 at 5.

[52] Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568 (1988). (Codified in scattered sections of 7 USC and 12 USC).

[53] Agricultural Credit Act of 1987, §§501-512, 7 USC §§5101-5106, 2006; 12 USC §2202e (1988).

## 1. Mediation

Title V propelled the Department of Agriculture into mediation by requiring the Secretary to certify and provide matching grants to state mediation programs that met certain criteria;[56] to participate in state mediation programs;[57] and to make "a reasonable effort" to contact and encourage creditors to take part in a restructuring plan.[58] To fulfill this last requirement, the FmHA included in its rules on restructuring a requirement that delinquent borrowers be offered a chance to participate in mediation or a voluntary meeting of creditors; in addition, it began a program to contract for mediation services in some states that lacked certified mediation programs.

Title V requires the Secretary to provide states that have "qualified" mediation programs with matching funds, limited to 50 percent of the cost of each program and to $500,000 for each state.[59] The Secretary must certify a state mediation program as "qualified" if the program:

> (1) provides for mediation services to be provided to producers, and their creditors, that, if decisions are reached, result in mediated, mutually agreeable decisions between parties under an agricultural loan mediation program;
>
> (2) is authorized or administered by an agency of the State government or by the Governor of the State;
>
> (3) provides for the training of mediators;
>
> (4) provides that the mediation sessions shall be confidential; and

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[54] S. Rep. No. 230, 100th Cong., 1st Sess. 6 (1987). See note 12, supra.

[55] Coleman v. Lyng, 864 F.2d 604 (8th Cir. 1988).

[56] Agricultural Credit Act of 1987, §§501-502, 7 USC §§5101-5102 (1988).

[57] Agricultural Credit Act of 1987, §503, 7 USC §5103 (1988).

[58] Agricultural Credit Act of 1987, §615(d)(2), 7 USC §2001(d)(2) (1988).

[59] Agricultural Credit Act of 1987, §502, 7 USC §5102 (1988).

> (5) ensures that all lenders and borrowers of agricultural loans receive adequate notification of the mediation program.[60]

Section 503 requires that "with respect to each program under the jurisdiction of the Secretary that makes, guarantees, or insures agricultural loans," the Secretary:

> (A) shall prescribe rules requiring that each such program shall participate in good faith in any state agricultural loan mediation program;
>
> (B) shall, on the date of enactment of this Act, participate in agricultural loan mediation programs; and
>
> (C) shall--
>
>> (i) cooperate in good faith with requests for information or analysis of information made in the course of mediation under any agricultural loan mediation program described in section 501; and
>>
>> (ii) present and explore debt restructuring proposals advanced in the course of such mediation.[61]

The statute also directs the Farm Credit Administration, an independent regulatory agency of the executive branch charged with regulating the Farm Credit System[62], to prescribe rules requiring its institutions, "(1) to cooperate in good faith with requests for information or analysis of information made in the course of mediation under any agricultural loan mediation program described in section 501; and (2) to present and explore debt restructuring proposals advanced in the course of such mediation."[63]

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[60] Id. §501(c).

[61] Id. §503(a).

[62] The Farm Credit Administration was established under the Farm Credit Act of 1971, 12 USC §2001 (1971), and regulates a collection of banks, associations, affiliated service organizations and other entities known as the Farm Credit System. The lending organizations--Farm Credit Banks, Banks for Cooperatives, the National Bank for Cooperatives, Federal Land Bank Associations, Agricultural Credit Associations, and Federal Land Credit Associations--"were established to provide adequate and dependable credit and closely related services to farmers, ranchers, and producers or harvesters of aquatic products; persons engaged in providing on-the-farm services; rural homeowners." United States Government Manual 1989/90 566 (1989). Initially capitalized by the government, these Farm Credit lending institutions now are organized as cooperatives and are completely owned by their borrowers. Funds are raised mainly through the sale of securities. Id.

In addition, the statute required the Secretary and the Farm Credit Administration to prescribe regulations to carry out these provisions[64] and directed the Secretary to report on the effectiveness of the program, recommendations for improvement, and "savings to states" that resulted from such programs.[65] Finally, the statute authorized an appropriation of $7,500,000 for each of the fiscal years 1988 through 1991.[66] In FY 1989, $3,000,000 was appropriated, allocated, and obligated.[67] In FY 1990, Congress appropriated $3,500,000[68] and OMB allocated $3,456,000.[69] In 1990, Congress extended this authorization through 1995.[70] For FY 1991, $3,750,000 was appropriated[71] and $2,932,450 was obligated.[72] For FY 1992, Congress again appropriated $3,750,000.[73] As of November 15, 1991, 10 states had requested a total of $1,606,437 in grants.[74]

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[63] Agricultural Credit Act of 1987, §503(b), 7 USC §5103 (1988). Note that in contrast to the DOA agencies, FCA is not explicitly required by the statute to require Farm Credit System institutions to "participate" in farm credit mediation. However, the requirement that it "present and explore debt restructuring proposals advanced in the course of such mediation" seems to imply participation, and the FCA apparently made that interpretation in promulgating rules. See notes 225-28, infra and accompanying text.

[64] Id. §504.

[65] Id. §505.

[66] Id. §506.

[67] Rural Development, Agriculture, and Related Agencies Appropriations Act, 1989, Pub. L. No. 100-460, 102 Stat. 2229, 2244 (1988).

[68] Rural Development, Agriculture, and Related Agencies Appropriation Act, 1990, Pub. L. No. 101-161, 103 Stat. 951, 966 (1989).

[69] Farmers Home Administration, Certified Mediation Program Forecasted Cash Needs FY 1991 (April 8, 1991).

[70] Food, Agriculture, Conservation and Trade Act of 1990 §1853, Pub. L. No. 101-624, 104 Stat. 3359, 3837 (1990) (to be codified at 7 USC §5106).

[71] Rural Development, Agriculture, and Related Agencies Appropriations Act, 1991, Pub. L. No. 101-506, 104 Stat. 1315, 1330 (1990).

[72] Telephone interview with Chester A. Bailey (Nov. 15, 1991).

[73] Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 1992, Pub. L. No. 102-142, 105 Stat. 878 (1991).

[74] Telephone interview with Chester A. Bailey (Nov. 15, 1991).

## 2. Loan Servicing

The Act included significant changes in the functioning of the FCA as well as the FmHA. The most important of these, for present purposes, were requirements that these lenders restructure loans where that is in the government's financial interests and would help keep the farmer on the farm.[75] The FmHA is required to modify delinquent farmer program loans...to the maximum extent possible--

> (1) to avoid losses to the Secretary on such loans, with priority consideration being placed on writing-down the loan principal and interest...and debt set-aside, whenever these procedures would facilitate keeping the borrower on the farm or ranch or otherwise through the use of primary loan service programs...and
>
> (2) to ensure that borrowers are able to continue farming or ranching operations.[76]

To be eligible for such assistance "the delinquency must be due to circumstances beyond the control of the borrower," and "the borrower must have acted in good faith...and must present a preliminary plan...that contains reasonable assumptions that demonstrate that the borrower will be able to--(A) meet the necessary family living and farm operating expenses; and (B) service all debts, including those of the loans restructured."[77]

In addition, "(4) the loan, if restructured, must result in a net recovery to the Federal Government, during the term of the loan as restructured, that would be more than or equal to the net recovery to the Federal Government from an involuntary liquidation or foreclosure on the property securing the loan."[78]

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[75] Restructuring requirements for the FCA are found in the Agricultural Credit Act, supra note 52 §102, 12 USC §2202a (1988).

[76] Id. §615(a) (1988).

[77] Id. §615(b).

[78] Agricultural Credit Act of 1987, §615(c), 7 USC §2001(c) (1988). It also sets out rules for determining net recovery, recovery value, and the value of the restructured loan.

(C) RESTRUCTURING DETERMINATIONS.--

(1) Determination of Net Recovery. In determining the net recovery from the involuntary liquidation of a loan under this section, the Secretary shall calculate--

(A) the recovery value of the collateral securing the loan, in accordance with paragraph (2); and

The Secretary is required to make such calculations within 60 days after receipt of a written request for restructuring and notify the borrower of the results. "[I]f the value of the restructured loan is greater than or equal to the recovery value" the Secretary shall "offer to restructure the loan obligations ...through primary loan service programs that would enable the borrower to meet the obligations (as modified) under the loan" and to continue farming.[79]

The statute also provides an option for some borrowers who do not meet the above criteria to buy out their FmHA loan for its net recovery value.[80]

Mediation is awarded a major role in the decision to restructure. The Secretary is to give priority to principal and interest write-down only if creditors..."(other than those creditors who are fully collateralized) representing a substantial portion of the total debt of the borrower held by such creditors, agree to participate in the development of the restructuring plan or agree to participate in a State mediation program."[81] Further, the Secretary is required to "make a reasonable effort" to contact and encourage the creditors to take part in the development of a plan of restructuring,[82] a notion that later became known as a "voluntary meeting of creditors."

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(B) the value of the restructured loan, in accordance with paragraph (3). The recovery value of the collateral securing the loan shall be based on--

(A) the amount of the current appraised value of the property securing the loan; less

(B) the estimated administrative, legal, and other expenses associated with the liquidation and disposition of the loan and collateral...the value of the restructured loan shall be based on the present value of payments that the borrowers would make to the Federal Government if the terms of such loan were modified under any combination of primary loan service programs to ensure that the borrower is able to meet such obligations and continue farming operations. Id.

A new and more restrictive method for determining eligibility for restructuring is set forth in the Food, Agriculture, Conservation and Trade Act of 1990, Pub. L. No. 101-624, §1816, 104 Stat. 3359, 3826 (amending 7 USC §353).

[79] Id. §2001(c)(5).

[80] Id. §2001(c)(6).

[81] Id. §2001(d)(1)(A).

[82] Id. §2001(d)(2).

## II. FmHA Implementation: Accomplishments

As the FmHA began to implement this program in January 1988, it faced a daunting situation: 85,000 delinquent Farmer Program borrowers and another 33,000 in an "inactive" status, such as bankruptcy or foreclosure.[83] The loan portfolio of delinquent FmHA farmer program borrowers totaled $11.4 billion (out of the total FmHA farm loan portfolio of $26 billion, which represented 15 percent of total farm debt). $9.6 billion in payments were overdue.[84]

In addition, and to make matters more difficult for the FmHA, it was operating under both federal court injunctions forbidding it to take further adverse actions until it revised the forms used to advise delinquent borrowers of servicing options and appeal rights[85] and Agricultural Credit Act requirements to revise substantially its procedures for dealing with delinquent borrowers.[86]

The statute not only called for the Department of Agriculture to certify state mediation programs and to participate in those programs that it certified, but also required that it make "a reasonable effort" to contact and encourage creditors to take part in a plan of restructuring. This led the FmHA both to encourage FmHA offices in states that lacked certified mediation programs ("noncertified states") to contract for mediation services and to provide, in its rules, that delinquent borrowers would have a chance to request mediation or a "voluntary meeting of creditors."

After explaining the promulgation of rules by the FmHA, I will review the progress it made in both certified and noncertified states.

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[83] C. Bailey, Interim Final Regulatory Impact Analysis, Restructuring Provisions of the Agricultural Credit Act of 1987 1 (August 1, 1988) (hereinafter "1988 Impact Analysis").

[84] Id.

[85] Note 83, supra.

[86] See Section I.D., supra. The Government Accounting Office suggested that for those FmHA borrowers who showed little or no likelihood of succeeding, job training or other assistance might be more appropriate than continuing to afford them subsidized credit. U.S. General Accounting Office, Farmers Home Administration: Farm Loan Programs Have Become a Continuous Source of Subsidized Credit (1988).

## A. Rulemaking

### 1. Mediation

#### a. Certified State Mediation Programs

The Agricultural Credit Act of 1987 was enacted on January 6, 1988. The FmHA published its proposed rule establishing the certification process and the basis for FmHA participation on May 16, 1988[87] and the final rule on August 26, 1988.[88] The final rule provided that the FmHA will participate in mediations conducted under a State agricultural loan mediation program "under the same terms and conditions applicable to agricultural creditors generally, and will cooperate in good faith in such mediations by complying with requests for information and analysis, and in presenting and exploring debt restructuring proposals, wherever feasible, when that State is...a qualifying State..."[89]

In setting out the requirements for certification of state programs, the rule imposed standards identical to those set forth in the statute. By August 1 of each year the state must request the funding, and its request must describe and document the program and include a certification by the governor, or the head of a state agency designated by the governor, that the program:

> (i) Provides for mediation services to be provided to producers, and their creditors, that, if decisions are reached, result in mediated, mutually agreeable decisions between the parties under the program;
>
> (ii) Is authorized or administered by an agency of the State government or by the Governor of the State;
>
> (iii) Provides for the training of mediators;

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[87] 53 Fed. Reg. 17198 (1988).

[88] 7 CFR §§1946.1-1946.50 (1991).

[89] 7 CFR §1946.1(b) (1991). In choosing to participate under the same terms and conditions as other creditors, the FmHA rejected a recommendation made in response to the proposed rule that the rule should provide that the FmHA's participation be mandatory. It stated that this was not required by the statute and that it would be "unusual for FmHA to decline to participate in a mediation." 53 Fed. Reg. 32598 (1988).

> (iv) Provides that the mediation sessions shall be confidential; and
>
> (v) Ensures that all lenders and borrowers of agricultural loans receive adequate notification of the mediation program.[90]

The FmHA rejected suggestions that the certification requirements be made more restrictive. Some comments on the proposed rule had urged that the FmHA impose minimum numbers of hours for training of mediators and detailed provisions as to "brochures, broadcast announcements, and notification of the mediator's names, addresses and phone numbers on foreclosure notices."[91] The FmHA rejected these proposals that it "micro-manage," stating that such provisions were not contemplated by the statute, and that varying local conditions could call for different activities in the states.[92] These decisions to defer to the state programs in the details of their activities seem not only consistent with the statute but also quite sensible. state programs, on the whole, seem to have carried out their tasks well, as described below.

The rule requires that states receiving matching funds provide an annual report to the FmHA state office by September 30 of each year on the effectiveness of the program; recommendations for improvements; and savings to the states. Further, the FmHA state office must provide comments and recommendations along with the report to the Administrator by November 1 of each year.[93] These requirements were intended to provide the FmHA with information it needs to comply with Section 505 of the 1987 Act, which required the Administrator to report on such matters to Congress by January 1, 1990.[94] In adopting these provisions, the FmHA decided against imposing detailed requirements for the annual reports from the state mediation programs. In retrospect, the wisdom of that decision is debatable. As will be detailed below, partly as a consequence of variations in reports submitted by the state programs, it has been difficult for the FmHA to have much confidence in some of the statistical information that it has submitted to Congress.[95]

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[90] 7 CFR §1946.3(a)(2)(i)-(v) (1991). The rule provides that within 15 days after receipt of a request for certification, the FmHA is either to notify the state whether it is certified as a qualifying state or to request additional information. If it requests additional information, it must notify the state of whether it is certified within 15 days of receipt of the additional information. Once the FmHA has notified the state that it is certified, the agency has 60 days "to review the State's application and supporting information for a grant, mail the obligation document to the responsible State government official for signature, to obligate funds, and to notify the State of approval." 7 CFR §1946.4(g)(1) (1991).

[91] 53 Fed. Reg. 32598 (1988).

[92] Id.

[93] 7 CFR §1946.4(j)(3) (1991).

[94] Agricultural Credit Act of 1987, §505, 7 USC §5105 (1988).

Finally, the FmHA Administrator delegated the authority for processing applications and awarding grants to the Assistant to the Assistant Administrator, Farmer Programs. This position has been occupied by Chester A. Bailey who has discharged these functions admirably.[96]

### b. Contract Mediation in Noncertified States

The rule also establishes mediation, or something approaching mediation, in states that do not have certified programs. It requires the state director to "provide the means of conducting a voluntary meeting of creditors, either with a mediator or a designated FmHA representative,"[97] encourages the state directors to "contract for qualified mediators within their jurisdictional areas,"[98] and provides that the "National Office will provide the state a list of qualified mediators for contracting purposes."[99] The rule goes on to provide that when a mediator is available, the County Supervisor will help the mediator schedule a meeting with the "borrower and all of the borrower's unsecured creditors, holding a substantial part of the borrower's debt and encourage them to participate in such a meeting. The mediator will be responsible for conducting the meeting *in accordance with accepted mediation practices* and to develop an Agreement to assist the farmers in resolving their financial difficulties."[100]

The rule also provides that when a mediator is not available, the county supervisor may designate an FmHA employee "to conduct a meeting of creditors and attempt to develop a plan with borrowers and their creditors that will assist the borrowers to resolve their financial difficulty."[101] This FmHA representative must not have been previously connected with the borrower's account, and must "have demonstrated good human relations skills and ability to resolve problems and settle disputes."[102] The state directors are to provide the training needed.[103]

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[95] Section III.A., infra.

[96] Mr. Bailey's performance in this project has been praised by virtually all of the persons I interviewed who were familiar with his efforts.

[97] 7 CFR 1951.912(b) (1991).

[98] 7 CFR 1951.912(b) (1991).

[99] Id. Sec. 1951.912(b) (1991).

[100] Id. Sec. 1951.912(b)(1) (1991) (emphasis added).

[101] Id. Sec.1951.912(b)(2) (1991).

## 2. The Place of Mediation in the Loan Servicing Process

On May 23, 1988, the FmHA published for comment a proposed rule that dealt with how the FmHA was to participate in mediation and service its loans;[104] on September 14, 1988, it published for comment the interim rule.[105] The FmHA planned to publish a final rule near the end of calendar year 1990 that would become final in January 1991.[106] However, significant changes in debt restructuring and loan servicing were made by the Food, Agriculture, Conservation, and Trade Act of 1990, which was enacted on November 28, 1990.[107] Accordingly, the rules that the FmHA was about to publish as final became obsolete.[108] The FmHA, of course, did not publish these rules, and it determined to begin publishing new rules--some of them interim rules--to implement the 1990 Act. Then, "at some time in the future," it will promulgate a final rule incorporating these interim rules, taking into consideration public comments, as well as the changes the FmHA planned to make in the 1988 rules.[109]

The interim rules include basic provisions on how the FmHA will participate in mediation.[110] They state that the FmHA will participate in certified state mediation programs "under the same terms and conditions as other creditors,"[111] establish a system for payment of mediation fees,[112] and may use primary loan service programs to assist borrowers who do not, or whose creditors do not participate in mediation.[113]

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[102] Id.

[103] Id. Sec. 1951.912(b)(6) (1991).

[104] Additional Amendments of Portions of Farmer Program Regulations, 53 Fed. Reg. 18392 (1988) (to be codified at 7 CFR Pt. 1951) (proposed May 23, 1988).

[105] Additional Amendments of Portions of Farmer Program Regulations, 7 CFR §1951.901 et seq. (1991).

[106] Telephone Interview with Chester A. Bailey, Assistant to the Assistant Administrator, Farmer Programs, FmHA (July 12, 1990).

[107] Food, Agriculture, and Trade Act of 1990, Pub. L. No. 101-624, §1816, 104 Stat. 3359, 3826 (1990).

[108] Telephone interview with Chester A. Bailey, Assistant to the Assistant Administrator, Farmer Programs, FmHA (Jan. 29, 1990).

[109] Id.

[110] 7 CFR §1951.912. An excellent explanation of the relevant FmHA rules is found in Farmers' Legal Action Group, FARM SURVIVAL HANDBOOK: A GUIDE TO FMHA DEBT RESTRUCTURING AND APPEALS (1988).

[111] 7 CFR §1951.912(a)(1) (1991).

[112] 7 CFR §1951.912(a)(2) (1991).

These rules also require the FmHA state director to designate a person to represent FmHA in mediations;[114] to provide that person with "adequate training",[115] as well as written authority, which "can vary from complete authority to act for FmHA, to a requirement for review and concurrence by the State Director or designee prior to approving a mediation agreement,"[116] and to prepare--after consulting widely--a "state supplement" that describes how the FmHA will participate in the state mediation program.[117]

These Rules also explain debt servicing, which they describe as "a continuing process, not a single event," with two objectives:

> (1) To help the farmers manage credit so they can return to private sector credit sources, and (2) to minimize costs to the Government of providing this opportunity to farmers in financial difficulty. Borrowers' accounts must be managed with an overall objective of keeping the farmer in business and at the same time, minimizing loan costs and losses."[118]

There are two basic kinds of loan servicing actions: primary loan servicing and preservation loan servicing.

**Primary loan servicing** includes:

- consolidation
- rescheduling and/or reamortization
- deferral of principal and interest payments
- reducing the interest rate
- writing down (reducing) amount of the debt
- a combination of these.[119]

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[113] 7 CFR §1951.912(a)(3) (1991).

[114] 7 CFR §1951.912(a)(4) (1991).

[115] 7 CFR §1951.912(a)(5) (1991).

[116] 7 CFR §1951.912(a)(4) (1991).

[117] 7 CFR §1951.912(a)(7) (1991).

[118] 7 CFR §1951.902(a) (1991).

[119] 7 CFR §1951.901 (1991).

**Preservation loan servicing** may be available to borrowers who are ineligible for primary loan servicing. Preservation loan servicing includes:

- leaseback/buyback and

- homestead protection.[120]

The Rules explain that the FmHA will send a notice[121] describing these options and the methods of applying for them to farmer program borrowers whose loans were accelerated between November 1, 1985 and May 7, 1987, to all other farmer program borrowers whose loans have been accelerated, to borrowers with pending bankruptcy proceedings whose accounts had not been foreclosed or liquidated, to borrowers who were 180 days delinquent, and to borrowers who were less than 180 days delinquent, and who the FmHA had determined, through the DALR$ program, were ineligible for primary loan servicing.[122]

The farmer who wishes to apply for servicing must complete numerous forms, the most important of which is the "farm-home plan," on which the farmer is to set forth all information relevant to his cash flow situation. Once this is done, the FmHA will determine whether the farmer is eligible for any of the primary loan servicing options.

The farmer will be considered eligible for a servicing option if he

1. Is unable to pay his debts to the FmHA for reasons beyond his control;

2. Has acted in good faith; and

3. Has a feasible plan.[123]

A "feasible plan" means that the farm-home plan shows a cash flow that allows the farmer to:

1. Pay necessary family living and farm operating expenses;

2. Pay all debts, including the restructured debt to FmHA; and

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[120] Id.

[121] 7 CFR Part 1951, Subpart S, Exhibit A and Attachments 1 and 2 (1991).

[122] 7 CFR §1951.907 (1991).

[123] 7 CFR §1951.909(c) (1991).

3. Pay FmHA an amount worth more than the "net recovery value" of the loan.[124]

Such criteria demand very complex computations. To aid its county offices in making the determination of eligibility for primary loan servicing, the FmHA has developed DALR$, the Debt and Loan Restructuring System, a computer program operated on the FmHA County Office computer systems.[125] The program assists the FmHA loan officer in making a decision "about whether any combination of primary loan servicing options will make it possible for the borrower to develop a feasible plan and thus stay on the farm and avoid loss to the government."[126] DALR$ considers the primary loan servicing options in the order listed above, that is, from the least to the most extreme.[127] The borrower is not eligible for debt write off if he is eligible for any of the less drastic options.

The county supervisor makes decisions as to the input, based on the farm-home plan submitted by the borrower and other factors, and the DALR$ program then quickly performs mathematical calculations which, if performed manually, would take a great deal of time and would run the risk of mathematical error. The DALR$ program provides a printout for the FmHA and the borrower.

If the DALR$ program shows that the borrower has a feasible plan, the FmHA will offer the primary loan servicing option for which the farmer is eligible. If, however, the DALR$ program shows that the borrower is ineligible for primary loan servicing, the FMHA will send a notice, along with a printout of the DALR$ program. This notice advises the farmer of the FmHA's conclusion that the farmer has been unable to develop a feasible plan because of debts to "lenders other than the FmHA."[128] It also includes one of the following two paragraphs:

(If a Certified State Mediation program is available)

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[124] 7 CFR §§1951.909(d) (1991). The "net recovery value" of a loan is the amount that FmHA estimates it would obtain if it forced the borrower out of business. 7 CFR §1951.909(f) (1991). To determine whether the borrower would be able to pay an amount that exceeded the net recovery value the FmHA determines the "present value" of the restructured loan. 7 CFR §1951.909(g) (1991).

[125] 7 CFR Part 1951, Subpart S, Exhibit J (1991).

[126] Id. The program uses the AT&T 3B2 computer system that is present in FmHA field offices. It runs on the a computer operating system called UNIX, which does not run on DOS on personal computers. Because of the expense, the FmHA "does not plan to develop duplicate computing capabilities on personal computers" but "will provide copies of program diskettes and/or source code to interested parties upon request." Id.

[127] Id.

[128] 7 CFR Part 1951, Subpart S, Exhibit E (1991).

> We are requesting mediation under the (Name) State Certified Mediation Program. We will work with you and your creditors to determine if your debts can be adjusted sufficiently to permit you to develop a feasible plan of operation. If, with the adjustment of your debt, you are able to develop a feasible plan of operation which shows that you can make an annual payment to FmHA of at least $_____, FmHA will reconsider your application for primary loan servicing.
>
> (If a certified State Mediation program is not available)
>
> We will schedule a meeting with you and your other creditors in an effort to reach agreements with them to adjust your debts sufficiently to permit you to develop a feasible plan of operation. The FmHA State Director will contract for a mediator or appoint an FmHA representative not previously involved in servicing of your account upon your written request to participate in the meeting with creditors.[129]

Notice that under these Rules, the FmHA does not request mediation until **after** it has determined that the borrower is ineligible for primary loan servicing. In addition, the Notice seems to suggest that the only purpose of the mediation is to seek to have the lenders other than FmHA adjust their debts so that the borrower can have a feasible plan under the DALR$ program. As explained below in Section III.E.2.b., this limitation has helped foster an inappropriately narrow focus in some mediations.

If the mediation produces debt adjustments that will permit the DALR$ program to show a feasible plan, the FmHA will offer the primary loan servicing option for which the borrower is eligible. If, however, the mediation does not produce those adjustments, the FmHA will send the borrower a notice that the FmHA intends to accelerate the loan and proceed against the property; this notice also explains that the borrower has appeal rights and an opportunity to purchase the land at its "net recovery value."[130]

If the farmer does not appeal or does not win the appeal and does not elect the "net recovery buyout," the FmHA will automatically consider the farmer for the two preservation loan servicing options--homestead protection and leaseback/buyback. Homestead protection allows the farmer to either obtain homestead protection, which allows the farmer to purchase the homestead (the house and up to 10 acres) or get a lease with an option to buy the homestead.[131] Under the leaseback/buyback program, the farmer leases the property with an option to buy.[132]

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[129] Id.

[130] 7 CFR §1951.909(H)(3)(iii) (1991).

County supervisors are authorized to make all loan servicing decisions except write down of debt, which must be approved by the state director.[133] But county supervisors also have authority to consolidate and reschedule/reamortize loans one time only. Authority for subsequent consolidation, rescheduling/reamorization is vested in state directors.[134]

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[131] 7 CFR §1951.911(b) (1991).

[132] 7 CFR §§1951.911(a), 1955.66(h) (1991).

[133] 7 CFR §1951.903(b) (1991).

[134] Id.

## B. State Mediation Programs

### 1. FmHA Certification

The FmHA certified and provided matching grants to 16 state programs prior to July 14, 1989: Alabama, Indiana, Iowa, Kansas, Minnesota, Mississippi, Montana, Nebraska, New Mexico, North Dakota, Oklahoma, South Dakota, Texas, Utah, Wisconsin, and Wyoming.[135] It subsequently certified Arkansas. Mississippi did not request certification for fiscal year 1991.[136] Oregon was certified in Fall 1990.[137] As of May 1991, there were 17 certified state programs.

The matching grants for FY 1989 totaled the full $3,000,000 appropriated and ranged from $500,000 for Minnesota and Texas to $12,000 for Utah.[138] For FY 1990, $3,500,000 was appropriated[139] and $3,456,000 was allocated to the state mediation programs.[140] The 1990 farm bill extended the authorization of $750,000 per year to 1995.[141] Congress appropriated $3.75 million for FY 1991[142] and $2,932,450 was obligated.[143] For FY 1992, Congress again appropriated $3,750,000.[144] As of November 15, 1991, 10 states had requested a total of $1,606,437 in grants.[145]

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[135] Farmers Home Administration, U.S. Department of Agriculture Report to Congress on Title V - State Mediation Programs, Subtitle A - Matching Grants for State Mediation programs 11 (1989) (hereinafter 1989 Report to Congress).

[136] Telephone interview with Chester A. Bailey, Assistant to the Assistant Administrator, Farmer Programs, FmHA (July 12, 1990). The FmHA office then contracted for new mediation services with former employees of the same state office that provided mediation under the previously-certified program. Telephone interview with Chester A. Bailey (May 15, 1991).

[137] Telephone interview with Chester A. Bailey (Jan. 29, 1991).

[138] U.S. Department of Agriculture. Farmers Home Administration, Title V - State Mediation Programs, Subtitle A - Matching Grants for State Mediation Programs, Report to Congress 11 (Dec., 1989) (hereinafter 1989 Report to Congress).

[139] Rural Development, Agriculture, and Related Agencies Appropriations Act, 1990, Pub. L. No. 101-161, 103 Stat. 951, 966 (1989).

[140] Farmers Home Administration, Certified Mediation Programs Forecasted Cash Needs FY 1991 (April 8, 1991).

[141] 7 USC §5106 (1990).

[142] Rural Development, Agriculture, and Related Agencies Appropriations Act, 1991, Pub. L. No. 101-506, 104 Stat. 1315, 1330 (1990).

[143] Telephone interview with Chester A. Bailey (Nov. 15, 1991).

[144] Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 1992, Pub. L. No. 102-142, 105 Stat. 878 (1991).

[145] Telephone interview with Chester A. Bailey (Nov. 15, 1991).

The FmHA has encouraged states to develop mediation programs and to apply for certification and matching grants. It announced the program in a certified letter to governors.[146] Program administrator Chester Bailey has worked extensively with individuals and organizations in numerous states who were trying to develop state mediation programs. The FmHA has expressed the hope that more states will establish certified programs,[147] and it continues to promote such developments.

## 2. Variety in Certified State Mediation Programs

The statute provides minimal and sparse standards for certification of state mediation programs.[148] The FmHA adopted these same standards in its rulemaking[149] and implementation, deciding not to control the details of the mediations or the mediation training in the certified state mediation programs. For that reason, and because of variations in local conditions, there are vastly different programs among the certified states. For example, the programs in Iowa and Minnesota, which predated the federal legislation, are "mandatory" in the sense that the farmer has the option of requiring certain creditors to participate in mediation before they may foreclose.[150] These two programs also provide the farmer with much more extensive preparation services than some of the other certified programs.[151]

There is also much variety among the other certified programs. Only two of these South Dakota and Arkansas are mandatory.[152] Many provide the farmers with significant support services, but they do so in different ways. In Kansas an elaborate support service network called Farmers Assistance Counseling and Training (FACTS), a unit of the Kansas Board of Agriculture, helps the farmers prepare for mediation.[153] Both the Texas[154] and the North

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[146] 1989 Report to Congress, supra note 135 at 2.

[147] Id. at 2.

[148] Text accompanying note 60, supra.

[149] Text accompanying note 88, supra.

[150] Iowa Code §634A.6 (1990); Minn. Stat. §583.26 (1986).

[151] For descriptions of the origins and functioning of these programs, see section I.C., supra, and section III.E.1.a., infra.

[152] S.D. Codified Laws Ann. §54-13-1 to 54-13-19 (1991); Ark. Stat. Ann. §§2-7-101 to 2-7-310 (1989).

[153] Memorandum from Don Reynolds, Chairman, Rural Assistance Corp., which provided mediation services as part of the Kansas certified program until late 1990, to Leonard Riskin (Sept. 4, 1990).

[154] Statement of Gary Condra, Director, Texas Agricultural Loan Mediation Program, at Coalition of Agricultural Mediation Programs (CAMP) meeting, St. Paul, Minn. (April 11, 1991).

Dakota programs assign "negotiators" to help the farmers prepare for the mediations and to represent the farmers during the mediation.[155]

The programs were started in many different ways and are organized differently. As mentioned previously, the Minnesota Program is operated by the University of Minnesota Extension, and the Iowa program by a nonprofit corporation created for this purpose.[156] The Nebraska program is conducted jointly by the Nebraska Legal Aid Society and the Interchurch Ministries of Nebraska under contract with the Nebraska Department of Agriculture.[157] In Texas the program is conducted by Texas Tech University.[158] In Kansas the program was originally operated by a nonprofit corporation and then transferred to the State Board of Agriculture.[159] The Oklahoma Department of Agriculture contracted with the Oklahoma Conference of Churches to operate its certified program.[160] Several programs, including those in Alabama, North Dakota, South Dakota and Utah, are conducted directly out of state offices.

There is great variety in the manner in which the mediators were selected and compensated.[161]

Notwithstanding these differences, these programs have something in common besides federal matching funds: they share a philosophy of mediation that differs from that which informs the mediation practitioners in some noncertified states, a matter discussed more fully in Section III.E., below.

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[155] North Dakota Department of Agriculture, North Dakota Agricultural Mediation Service (brochure); letter from Gary Condra, Director, Texas Agricultural Loan Mediation Program, to Leonard Riskin (June 29, 1991).

[156] Notes 44-45, supra, and accompanying text.

[157] Discussion with Kathleen Severens, Coordinator, Nebraska Mediation Service, Walthill, Neb. (St. Paul, Minn., April 12, 1991).

[158] Texas Agricultural Loan Mediation Program, Texas Tech University, Annual Report, Oct. 1, 1988-Sept. 30, 1989 (1989).

[159] Interview with Earl Wright, Farm Financial Specialist, Farmer's Assistance, Counseling and Training, Kansas Board of Agriculture ( St. Paul, Minn., April 12, 1991).

[160] Telephone Interview with James Stovall, Jr., State Coordinator, Agriculture Mediation Program, Oklahoma City (April 10, 1990).

[161] Statements submitted to me by certified state program leaders at the CAMP meeting on April 12, 1991 show a great range of compensation for mediators. The Oklahoma program pays only mileage. Statement of James Stovall, Jr., State Coordinator, Agriculture Mediation Program (April 12, 1991). Mediators in Arkansas receive $55 per session. Statement of Richard S. Johnson, Farm Mediation Program Coordinator, Arkansas Development Finance Authority (April 12, 1991). The South Dakota program pays $25 per hour in mediation sessions and $10 per hour for travel. Statement of Russell L. Stone, Director, Mediation Services, South Dakota Department of Agriculture (April 12, 1991).

## 3. Benefits and Costs

### a. Numbers of Mediations

The FmHa farm-credit mediation program plainly has accomplished a great deal and produced enormous cost savings to both the federal government and the states[162]. Unfortunately, however, it is extremely difficult--for two reasons--to give details to support that statement. The FmHA currently is unable to produce an accurate report or a good estimate of the numbers of cases that have been mediated in either certified or noncertified states. Accordingly, it is difficult to estimate financial savings. Of course, it is virtually impossible to put the very important intangible benefits into a cost-benefit analysis.

At a CAMP meeting on March 29, 1990, program administrator Chester Bailey distributed a document dealing with mediations conducted by certified state mediation programs.[163] The document indicated that 4,608 mediations had been conducted in the 16 then-certified programs as of November 30, 1989. This estimate, however, was based on reports to the FmHA from certified state mediation programs, and these reports were not uniform; they did not use the same categories, definitions, or time periods.[164] As a result, the estimate's accuracy is doubtful.[165]

The computerized information system that the FmHA operates shows only mediations pending.[166] Thus, the FmHA reports that as of November 11, 1990, a total of 518 mediations were pending nationally. Of these, 439, or 84 percent, were in certified states.

Recognizing this problem, leaders of state certified mediation programs agreed with Chester Bailey to adopt a uniform reporting form on which they would submit regularly to Micheal Thompson, Executive Director of the Iowa Mediation Service, who would compile and submit the data to Chester Bailey.[167] Although the form was developed and circulated, as of April 12, 1991, only eight of the mediation programs had submitted this data.[168] Based on the data submitted, in fiscal year 1990, 1,735 cases were mediated by the certified programs in Kansas, Iowa, Minnesota, Montana, North Dakota, Nebraska, South Dakota and Wisconsin.[169] The agreement rates ranged from 55.5 percent in Minnesota to 93 percent in Montana.[170]

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[162] In its Report to Congress in January 1989, the FmHA listed several measures of the program's effectiveness: 1. heightened public awareness of mediation; 2. requests for mediation from both borrowers and creditors; 3. agreements reached in the majority of cases mediated and communications facilitated in many cases; 4. cost savings to parties; 5. high levels of party satisfaction; and 6. increased awareness among farmers of opportunities for assistance in both financial and interpersonal matters as well as education. 1989 Report to Congress, supra note 136 at 5-6. The report describes some progress on each of these measures, supra.

[163] Farmer's Home Administration, Farm Loan Mediation v. Voluntary Meeting of Creditors (Information obtained from draft Status Report of 1951-S as of 11/30/1989).

[164] Consensus of discussion among leaders of state certified programs and Chester A. Bailey at CAMP meeting, Shawnee Mission, KS (Mar. 29, 1990).

[165] Id. It is likely that the total estimate was based upon overestimating mediations in some states and underestimating in others. Accordingly the estimated total could well approximate the actual number of mediations conducted during this period.

[166] Telephone interview with Chester A. Bailey (April 8, 1991).

Plainly, an evaluation of the program would benefit from more accurate information about how many mediations have been conducted. While the basic information is available in the annual reports submitted to the FmHA, the lack of uniformity in the reporting procedures renders any resulting estimates too speculative.

### b. Financial Costs and Savings

Using the assumption described above, that 4,608 mediations were conducted by certified state programs as of November 30, 1989, the FmHA has estimated that the average cost to the government per mediation in the certified states was $651,[171] a conclusion reached by dividing 4,608 into $3 million, the amount of matching grant funding received by certified states[172] in fiscal year 1989.

The FmHA also has attempted to calculate benefits. The FmHA predicted that the net savings to states during fiscal year 1989 would be between $18,191,761 and $36,974,302[173] and that the federal government would save between $6,600,000 and $14,760,000. For the federal government, this means gross benefits of between $3.20 and $5.92 for each matching dollar.[174]

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[167] Id.

[168] Statement of Micheal Thompson, Executive Director of Iowa's Farmer Creditor Mediation Service, Inc. at CAMP meeting, St. Paul, Minn. (April 12, 1991).

[169] FmHA, USDA Certified State Agricultural Mediation Programs, October 1, 1989 to September 30, 1990 (document distributed at CAMP meeting, April 11, 1991, St. Paul, Minn), a copy of which is attached as Exhibit A.

[170] Id.

[171] C. Bailey, Justification for the Extension of the Subtitle A USDA Certified State Agricultural Loan Mediation Grant Program After Fiscal Year 1991 at 3 (Mar. 22, 1990).

[172] Id.

[173] 1989 Report to Congress, supra note 136 at 11.

[174] Id. at 12. This estimate was based on a then-in-progress study of the Texas state certified mediation program by researchers at Texas Tech University. The measure of savings used in that study was the difference between the value of the restructured loan and the net recovery value of

One can quarrel with the assumptions and methodology underlying these calculations, of course, but it is clear that the program has resulted in substantial savings to states, to the U.S. Department of Agriculture, and to private lenders.

There are other financial savings. Every mediation that prevents litigation also saves money for taxpayers and creditors, including the expense of loan administration, and in the case of a government lender, handling appeals.[175] When a mediation results in a restructured loan or another outcome that keeps a farmer on the farm, there are many benefits to the local community or economy. Each job lost causes a "ripple effect" in the community and reduces the tax base.[176]

### c. Other Benefits

Other savings are impossible to measure but valuable nonetheless. Participants in farmer-lender mediation in North Dakota and in Texas report high degrees of satisfaction with the process, though generally borrowers were more positive about the program than were lenders.[177]

Studies in Minnesota have confirmed the beliefs of many mediators that farm-credit mediations have restored disrupted communications between farmers and lenders,[178] helped farmers avoid personal crises,[179] and promoted

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the collateral. Using this measure, the Texas Tech study-in-progress found a gross savings of $60,662 for each case that resulted in loan restructuring.

Subsequently, in the final version of that study, the authors determined, based upon a review of 75 cases mediated in Texas, that the benefits to FmHA averaged $35,363 and the benefits to other creditors averaged $19,187. Darren S. Edwards and Gary D. Condra, A Benefit Cost Analysis of the Texas Agricultural Loan Mediation Program (May 1991) (forthcoming, Texas Tech University College of Agricultural Sciences Publication No. ____.); letter from Gary Condra, Director, Texas Agricultural Loan Mediation Service, to Leonard Riskin (June 29, 1991).

[175] 1989 Report to Congress, supra note 136 at 8-9.

[176] Id. at 8.

[177] J. Baltezore, C. Gustafson, F. Leistritz, Evaluation of North Dakota's Agricultural Mediation Service (North Dakota Department of Agricultural Economics, 1990); M. Stratton, G. Condra, and S. Morse, A Survey of Participant Views of the Effectiveness of the Texas Agricultural Loan Mediation Program (May 1991) (Review Draft of forthcoming Texas Tech University College of Agricultural Sciences Publication No.____). NonFmHA lenders were more positive than FmHA representatives. Id. at 23.

[178] R. Krueger, M. Mueller and M. Casey, An Assessment of Farm Credit Mediation (1986), in Minnesota Extension Service, Farm Credit Mediation Studies 1986-1990 1 (1990); R. Krueger, T. Borass, and T. Ahles, Farm Credit Evaluation Report for Pope County Minnesota, in Minnesota Extension Service, Farm Credit Mediation Studies 1986-1990 (1990).

[179] Id.

peaceful change in farm communities.[180] In addition, mediation has improved farmer's decisionmaking, not just in the mediation, but also afterwards, and, most fundamentally, helped keep farmers on their farms.[181]

Other possible benefits of mediation are difficult to identify or measure. For instance, through mediation, farm families might learn of counseling or educational services that could reduce stress or lead to additional income. When mediation helps a farmer better understand his options, it may produce a resolution that is more satisfying and workable to the farmer, even if that means getting off the farm.[182]

## 4. The Coalition of Agricultural Mediation Programs (CAMP)

In 1989, leaders of certified state mediation programs created the Coalition of Agricultural Mediation Programs (CAMP). It "provides a framework for people to work together on: (1) common legislative goals; (2) expansion of USDA's use of mediation beyond FmHA farm debt restructuring; and (3) representing an promoting rural/agricultural mediation."[183]

The organization has greatly strengthened the FmHA's matching fund program by allowing members to share ideas about problems and solutions and join together in addressing these problems by working with appropriate federal agencies. It has co-sponsored, with the Conference, a program to acquaint federal agencies with farmer-lender mediation and encourage them to participate in mediation in cases in which they are involved.[184] CAMP has continued the promotional and organizational work that was carried out by the Conflict Clinic, Inc. from 1985 to 1989. But the Conflict Clinic, Inc. maintains a public relations and assistance role.[185]

Until the advent of farmer-lender mediation, most American mediators worked largely in urban areas. CAMP represents a large corps of mediators experienced in rural matters, an important national resource, which has developed principally because of the farmer-lender mediation program.

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[180] R. Krueger, M. Mueller and M. Casey, supra note 178.

[181] Id.

[182] See Section III.D., infra.

[183] Coalition of Agricultural Mediation Programs Mission Statement (September 6, 1990).

[184] Text following note 245, infra.

[185] The Conflict Clinic, Inc. undertook a successful effort to persuade the National Institute for Dispute Resolution to publish a symposium on farmer-lender mediation in its Fall 1990 issue. Letter from Frank Blechman, Associate, The Conflict Clinic, Inc., Fairfax, Va., to Leonard Riskin (June 21, 1991). Conflict Clinic Associate Frank Blechman facilitated an important part of the CAMP meeting on Sept. 5, 1990 in Washington, DC.

## 5. Extension of Mediation to Other Rural Matters.

Extending mediation services to rural matters other than farm credit is an explicit goal of CAMP[186] At CAMP meetings, the conventional wisdom is that both CAMP and FmHA should address not only the crisis in the farm sector, but also a chronic condition in rural America marked by a deterioration in the social fabric in many rural communities.[187] In the words of Micheal Thompson, Executive Director of the Iowa Farm Mediation Service:

> When you are a community, being in court may be the worst thing for you. You are concerned that the court experience will not only destroy individuals, but the whole relationship which is needed to maintain rural ties and rural fiber. Rural fiber is made up of people working together...What happened with the farm crisis that the social fabric was shaken and in some cases ripped. Mediation is helping to restore that fabric.[188]

In some states, farm-credit mediation programs have begun to mediate other kinds of matters connected to rural communities.[189] In Kansas, for instance, farm credit mediators have started a program to mediate with extended families that are coping with passing a farm from one generation to another.[190] And the Iowa legislature recently extended the Farm Mediation Service, which was subject to a July 1, 1990 "sunset" provision, and expanded its mandate to include other disputes involving farmers, such as care and feeding contracts, and nuisance and conservation matters.[191]

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[186] Id.

[187] For a discussion of this chronic condition, see text accompanying notes 19-20, supra, and National Mental Health Association, Report of the National Action Commission on the Mental Health of Rural Americans (1988).

[188] BNA, Farm Mediation Service Director and Mediator Discuss Use of Process in New Rural Disputes, 4 Alternative Dispute Resolution Report 198 (June 7, 1990).

[189] Mueller, Expanding Uses of Farm Mediation, in National Institute for Dispute Resolution Forum 13-14 (Fall 1990).

[190] Interview with Joanne Katz, Kansas farm credit mediator (April 5, 1991). For a discussion of this problem, see D. Jonovic and W. Messick, Passing Down the Farm (1986).

[191] Iowa Code §654B (1990). In a care and feeding contract, a farmer agrees to feed livestock owned by another; the compensation is a share of the profits from the sale of the animals. Sometimes an owner will pressure the farmer to make improvements and then, after the farmer has borrowed money to finance the improvements, the owner will back out of the contract, leaving the farmer unable to service the loan. Farm Mediation Service Director and Mediator Discuss Use of Process in New Rural Disputes, 4 BNA ADR Rep. 198 (June 7, 1990).

Before that statute was enacted, the Iowa Mediation Service had tested mediation in these areas.[192] In addition, it had used mediation or negotiated regulation in helping FCA, farmers, farm advocates, and the FmHA work out the FCA's implementation of the 1987 Agricultural Credit Act.[193] More recently, in April, 1991, it facilitated a meeting of 35 rural service providers "to share their vision of Iowa today and to explore directions for the future."[194] The Iowa Mediation Service also is developing a project to help integrate the work of providers of credit and other services to farmers.[195]

These developments exemplify mediation's potential for promoting more collaborative ways of planning and of resolving disputes in rural America.

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[192] Telephone interview with Micheal Thompson, Executive Director, Iowa Mediation Service (May 15, 1991).

[193] Telephone interview with Micheal Thompson, Executive Director, Iowa Mediation Service (May 15, 1991).

[194] Rural Providers Task Force Formed, Iowa Mediation Spotlight, June 1991, p. 1, col. 1.

[195] Telephone interview with Micheal Thompson, Executive Director, Iowa Mediation Service (July 1, 1991).

## C. Contract Mediation in Noncertified States

### 1. Contracting and Managing Contractors

Numerous FmHA offices in states without certified programs--including Kentucky, Louisiana, Maine, Maryland, Mississippi, Missouri, New Mexico, North Carolina, Ohio, Tennessee, Washington, Wyoming and, probably, others--awarded contracts for mediation services to private individuals or organizations.[196] Unfortunately, the FmHA does not have accurate records of the states in which its offices have contracted for mediation services.[197] In addition, there is no readily-available source of information on the numbers of mediations conducted in these states.[198]

In 1989, the FmHA contracted with the Federal Mediation and Conciliation Service (FMCS) to provide pilot mediation services in Georgia, Maine and New York.[199] In some states the FmHA arranged for its own employees to preside at "voluntary meetings of creditors."

The FmHA sponsored numerous mediation training programs for FmHA representatives or contractors in noncertified states. In Summer 1987, Kathy Mangum, director of the Minnesota Farm Credit Mediation Program, conducted a national program for officials of all state FmHA offices, and a similar program in Vermont.[200] Shortly thereafter, she presented a seminar, arranged by the FmHA's Colorado office, for FmHA personnel from about 10 Western states.[201] Micheal Thompson, Director of the Iowa Certified Mediation program, has provided training in Illinois, Missouri, North Carolina, and South Carolina,[202] as well as in several states with certified mediation programs.[203] In 1988, he conducted a training program in Maine for all FmHA state directors.[204]

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[196] The contracting process is described in the text accompanying notes 304-16, infra.

[197] Telephone interview with Chester A. Bailey (April 8, 1991).

[198] Section III.A., infra.

[199] Telephone interview with Peter J.B. Swanson, ADR Coordinator, Federal Mediation and Conciliation Service (Feb. 22, 1991). See also text accompanying notes 287-89, infra.

[200] Telephone interview with Kathy Mangum, Program Director, Farm Credit Mediation, University of Minnesota Extension Service (Sept. 20, 1990).

[201] Id. When the Mississippi legislature enacted a statute that would lead to certification of a state mediation program, a group from that state came to Minnesota for their training and returned to Mississippi to train the rest of the mediators. Id.

[202] Arkansas subsequently was certified.

In 1989, the Federal Mediation and Conciliation Service conducted training programs for FmHA staff in Georgia, Maine, New Mexico, New York, and Virginia, and in Fall 1990 conducted "retrainings" in North Dakota and South Dakota.[205] Doubtless other mediation training programs took place as part of the FmHA's efforts in noncertified states; there is no way for me to learn of them.

As best as I can determine, all of these programs were directed toward the broad, open process that was adapted to farmer-lender mediation by the Iowa and Minnesota programs and which served as a model for certified state programs. However, for reasons I will discuss below, many mediations conducted in noncertified states apparently tended to embrace a different and narrower vision of mediation.[206]

## 2. The Roster of Mediators

The FmHA undertook to develop a roster of individuals and organizations willing to provide farmer-lender mediation services. The principal, original objective of this effort was apparently to assist FmHA offices in noncertified states and territories in procuring mediation so as to provide services that were comparable to those in certified states.[207]

The roster was developed under a contract with Kendrick and Company, Washington, DC, with the FmHA's Training and Development Division.[208] That contract also covered development of brochures to help promote the program. Kendrick and Company subcontracted with the Conflict Clinic at George Mason University for much of the work required for both projects.[209]

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[203] Arkansas, Nebraska, and Wyoming. Telephone interviews with Micheal Thompson, Executive Director, New Iowa Mediation Service (formerly Iowa Farmer-Creditor Mediation Service) (April 18, 1990 and July 1, 1991).

[204] Id. (July 1, 1991).

[205] Id. See also Lobel, Farmer-lender Mediation, Dispute Resolution and Democracy, Proceedings of the 17th Annual Conference of the Society of Professionals in Dispute Resolution 199 (1989).

[206] Sec. III.C.2.b., infra.

[207] Memorandum from Glenn J. Hertzler, Jr., Assistant Administrator, Farmer Programs, FmHA to Michael J. Wilkinson, Deputy Administrator, Program Operations, (Sept. 26, 1988); 54 Fed. Reg. 22342 (1989).

[208] Telephone interview with Frank Blechman, Associate, The Conflict Clinic, Fairfax, Va. (April 11, 1990).

[209] Id. The brochure effort apparently went smoothly. The two brochures--Farmers Home Administration, FmHA Farmer-Creditor Mediation, A Guide for Use in States With Certified

In accordance with the contract, Kendrick delivered a separate roster for each state and the District of Columbia, and each roster had three sections: 1) individuals and organizations available to provide mediation services in any part of the jurisdiction; 2) those available for only certain areas within the jurisdiction; and 3) those who would provide services any place in the United States.

The report on each individual included information provided by that individual concerning his or her credentials, training, mediation experience, years in practice, areas of service, fees, availability, conflicts of interest and references.

Timing turned out to be the flaw in this project. The FmHA's goal was to provide FmHA state directors with the rosters by September 1989,[210] but the rosters were not delivered until June 1990,[211] too late for them to be very useful in fulfilling their original purposes in fiscal year 1990.

The first step in the roster process was soliciting information from mediators who wished to be listed. A March 10, 1989 version of the solicitation materials stated that providers should submit their application by June 1, 1989.[212] The FmHA's Submission of Information Collection to OMB was published in the Federal Register on May 23, 1989.[213]

Sometime in July 1989 OMB cleared the survey.[214] But it had approved a version that said the survey would be sent in April.[215] Thus, final OMB approval was not secured until August 1, 1989.[216] Shortly thereafter, 40,000 copies of the survey were printed.[217] They listed the deadline as September 15, in anticipation that mailing would begin between August 15 and 25. But the prime contractor did not mail some surveys until September 15. FmHA extended the deadline for application submission to November 15, and gave the contractor until January 1, 1990 to deliver the roster. Sometime in

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Agricultural Mediation Programs (Program Aid 1455, 1989) (Brochure) (emphasis in original) and Farmers Home Administration, FmHA Farmer-Creditor Mediation, A Guide for Use in States **Without** Certified Agricultural Mediation Programs, (Program Aid 1454, 1989) (Brochure) (emphasis in original)–were published in December 1989, and distributed in January 1990. Id.

[210] 54 Fed. Reg. 22341 (1989).

[211] Telephone interview with Chester A. Bailey (July 12, 1990).

[212] Statement of Duties, Qualifications and Responsibilities for Mediation of FMHA Credit Disputes, with attached application (Mar. 10, 1989).

[213] 54 Fed. Reg. 22341 (1989).

[214] Telephone interview with Frank Blechman, Associate, Conflict Clinic, George Mason University, Fairfax, VA. (April 11, 1990).

[215] Id.

[216] Id.

[217] Id.

December 1989, the Conflict Clinic completed its work.[218] The rosters finally were distributed in June 1990.[219]

These state rosters would have served their primary purpose well if they had been distributed much earlier. As it was, the distribution came too late to provide much help to state FmHA State Directors in contracting for mediation services in fiscal year 1990.[220] However, state directors have, and continue to use, the roster as appropriate.[221] In addition, the effort probably produced a public relations benefit[222] and certainly helped state FmHA offices solicit new mediation providers to supplement current providers.[223]

The roster was conceived as a one-time product that would not be updated, and this for two reasons. First, the FmHA perceived an urgent need to help state offices contact mediators. Once the initial contracting was effected, such state FmHA offices presumably would be sufficiently familiar with available providers.

Second, to the extent that FmHA state directors still needed information about providers, it would be available through a roster of dispute resolution neutrals developed and maintained by the Administrative Conference of the United States (ACUS). The Conference roster is designed to include providers of a wide-range of dispute resolution services touching many agencies and areas of activity.[224] Unlike the FmHA roster, the ACUS roster is not printed for distribution. Instead, federal agencies and entities that are involved in disputes with federal agencies can request ACUS to select the names of several neutrals who seem to match the needs of the participants. Thus, a state FmHA office could request a list of individuals and organizations that could provide farm-credit mediation services in that state.

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[218] Id.

[219] Telephone interview with Chester A. Bailey (July 12, 1990).

[220] Telephone interview with Frank Blechman, Associate, The Conflict Clinic (April 11, 1990); telephone interview with Chester A. Bailey (July 12, 1990).

[221] Letter from Chester A. Bailey to Leonard Riskin (June 17, 1991), "Administrator of FmHA, LaVerne Ausman, wrote all State Directors, ATTN: Farmer Program Chiefs, May 4, 1991, advising them and authorizing State Directors to contract for qualified mediation and mediation training. The letter provided a list of training resources..." Id.

[222] Telephone interview with Chester A. Bailey (July 12, 1990).

[223] Mississippi did not apply for recertification in 1990 because the state did not provide matching funds. However, the Mississippi FmHA office has contracted for mediation services with former state employees who had operated the certified program. Telephone interview with Chester A. Bailey (May 15, 1991).

[224] Office of the Chairman, Administrative Conference of the United States, An Introduction to ADR and the Roster of Neutrals 7 (1989); Administrative Conference of the U.S. Offers Neutrals List for Federal ADR, 8 Alternatives to the High Cost of Litigation 86 (May, 1990).

# III. FmHA Implementation: Problems

An effort as vast and diverse as the farmer-creditor mediation program is bound to encounter many difficult problems. The main obstacle to describing the problems in a report such as this is that they vary from state to state and from time to time; the programs in each state are unique and so are the personalities and circumstances of the participants in individual mediations.

Accordingly, in this Part, I describe just four problems that seem to have broad significance: the absence of reliable data on numbers of mediations; participation in mediation by other creditors, including other federal agencies; the potential decline in state financial support for farmer-lender mediation; and, most important, the development of, and tension between, two different notions of the nature and purposes of mediation.

## A. Lack of Reliable Data on Numbers of Mediations

The FmHA currently is unable to report accurately on the numbers of mediations conducted in either the certified or noncertified states.[225] For the certified states the problem is easily solved: there is a uniform reporting system;[226] what is needed is for all certified state programs to use this form to submit data. For the noncertified states, however, there is no system for reporting anything other than pending mediations.[227]

## B. Participation of NonFmHA Creditors

Some state mediation program directors have indicated that, at certain times, they have had difficulty in securing satisfactory participation of nonFmHA creditors, most notably lenders that were part of the Farm Credit System, a collection of cooperative agricultural lending institutions regulated by the Farm Credit Administration.[228] The Farm Credit Administration has promulgated rules that require Farm Credit System institutions to participate in certified state mediation program mediations that are "initiated by a borrower" and allow these institutions to "initiate mediation at any time."[229] The rules also provide that the institutions must "cooperate in good faith with requests for information or analysis of information" in connection with such programs[230] and that they may not "make a loan secured by a mortgage or lien...on the condition that the borrower waive any right under the agricultural loan mediation program of any state."[231]

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[225] Section II.B.3.a., supra.

[226] Text accompanying notes 168-69, supra.

[227] Telephone interview with Chester A. Bailey (April 8, 1991).

[228] For a description of the Farm Credit System, see note 62, supra.

Dennis McGilligan, Coordinator of the Wisconsin Farm Mediation and Arbitration Program, states that the "reluctance of [nonFmHA creditors, especially Farm Credit System lenders] has harmed mediation efforts in our state."[232] At an April 11, 1991 meeting of CAMP, several leaders of state mediation programs reported dissatisfaction with the participation of the Farm Credit System institutions. According to one report, for example, officials of FCA institutions in Nebraska are "reluctant to refer cases and, when they participate, reluctant to give anything up."[233]

There also were mixed and positive reports on the involvement of institutions belonging to the Farm Credit System (FCS). In Kansas, Farm Credit participates in mediation, according to Farm Financial Specialist Earl B. Wright.[234] He explains that usually Farm Credit institutions are in a first mortgage position. When these institutions are secured, "they have little incentive to negotiate but will participate in mediation. When they are under secured and if they restructure the loan a direct debt forgiveness is not often seen. Whereas with FmHA, a restructured loan will often include a debt forgiveness and therefore provides an opportunity for negotiations."[235] In Kansas, the Farm Credit institutions advise the borrower of the availability of mediation when notifying a farm borrower of intent to accelerate or call a note or before filing a suit to foreclose, as is required of all creditors by Kansas law.[236] Farm Credit in North Dakota also notified its borrowers of the mediation option, reasoning that this is required by the Agricultural Credit Act of 1987[237] and cooperates well with the certified mediation program.[238] The director of the Alabama mediation program indicated success in encouraging Farm Credit participation, in part by replacing terms such as "negotiation" and "liquidation" with concepts such as "shaping", "molding" and "structuring."[239] And Farm Credit has been cooperative in Arkansas.[240] In Oklahoma, Farm Credit includes a letter dealing with farmer-lender mediation in its bank closing materials.[241]

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[229] 53 Fed. Reg. 35456 (Sept. 14, 1988), 12. CFR §614.4521(a) (1991). Note that this requirement may go slightly beyond the explicit requirements of the statute. See note 63 and text accompanying notes 62-63, supra.

[230] Id. §614.4521(b) (1991).

[231] Id. §614.4521(c) (1991).

[232] Memorandum from Dennis McGilligan, Coordinator, Wisconsin Farm Mediation and Arbitration Program to Charles Pou, Jr., Administrative Conference of the United States (Oct. 31, 1991).

[233] Statement of Mark Galvin, Director, Nebraska Farm Mediation Program, at CAMP meeting, St. Paul, Minn. (April 11, 1991).

[234] Letter from Earl B. Wright, Farm Financial Specialist, Kansas Farmers Assistance Counseling and Training Service, to Leonard Riskin (June 19, 1991).

[235] Id.

[236] Kan. Stat. Ann. §74-545(g) (1989).

The Iowa mediation program director stated that although the Farm Credit Services office in Omaha "sees the crisis as over," the Iowa Farm Credit institutions are quite supportive and even make voluntary requests for mediation.[242] However in Minnesota, Farm Credit requires its borrowers to waive mediation in exchange for the Farm Credit's willingness to enter into a shared appreciation agreement.[243]

Other innovative, collaborative efforts with federal agencies were mentioned. The Small Business Administration participates effectively in Oklahoma[244] and Texas,[245] but does not refer cases.

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[237] Statement of L. Roger Johnson, Director, Agricultural Mediation Program, North Dakota Department of Agriculture, at CAMP meeting, St. Paul, Minn. (April 11, 1991).

[238] Statement of John Nowatski, Mediator, North Dakota Agricultural Mediation Service, at CAMP meeting, St. Paul, Minn. (April 11, 1991).

[239] Statement of John C. Gamble, Program Director, Alabama Farm Crisis and Transition Program, at CAMP meeting, St. Paul, Minn. (April 11, 1991).

[240] Telephone interview with Richard S. Johnston, Farm Mediation Program Coordinator, Arkansas Development Finance Authority (July 1, 1991).

[241] Statement of James Stovall, Jr., State Coordinator, Oklahoma Agriculture Mediation Program, at CAMP meeting, St. Paul, Minn. (April 11, 1991).

[242] Statement of Micheal Thompson, Executive Director, Iowa Mediation Service, at CAMP meeting, St. Paul, Minn. (April 11, 1991).

[243] Id.; statement of Kathy Mangum, Director, Farm Credit Mediation Program, University of Minnesota Extension Service, at CAMP meeting, St. Paul, Minn. (April 11, 1991).

The FCS in North Dakota was persuaded to give up this practice by the North Dakota certified mediation program. Statement of L. Roger Johnson, Director, Agricultural Mediation Program, North Dakota Department of Agriculture at CAMP meeting, St. Paul, Minn. (April 11, 1991). The FCS in North Dakota sends notices of the availability of mediation to any borrower whose loan becomes delinquent (with a copy to the North Dakota Agricultural Mediation Service). Letter from L. Roger Johnson to Leonard Riskin (June 14,1991).

[244] Statement of James Stovall, Jr. Id.

[245] Statement of Carter Snodgrass, Texas Agricultural Loan Counseling and Mediation Program, at CAMP meeting in St. Paul, Minn. (April 11, 1991).

Numerous mediation providers stressed the value of including the Small Business Administration, Federal Deposit Insurance Corporation, Resolution Trust Corporation, and the Internal Revenue Service.

The FmHA has worked to induce other federal agencies to participate in farmer-lender mediation and to interest agencies generally in alternative dispute resolution. On September 5, 1990, Chester Bailey hosted and made a presentation on farmer-lender mediation at a workshop co-sponsored by CAMP and the Conference. The goal was to acquaint the relevant agencies with these mediation programs and to encourage them to participate in such mediations when they are involved with the underlying problems. Represented federal agencies included the Farm Credit Administration and the U.S. Department of Agriculture's Agricultural Soil Conservation Service and Office of the General Counsel-National Resources, the Federal Deposit Insurance Corporation, the U.S. Army Corps of Engineers, the Department of Health and Human Services, the Small Business Administration, and the Resolution Trust Corporation.

## C. Participation of Parties to Guaranteed Loans

The FmHA loans discussed thus far in this report have been direct loans to farmers. In addition, the FmHA operates a program under which it guarantees loans made by banks.[246] In recent years, Congress has appropriated substantially more funds for guaranteed loans than for direct.[247]

Several leaders of certified state mediation programs have expressed concern at restrictions on their ability to encourage the parties to such loans to participate in mediation. Specifically, they have indicated that FmHA state offices have been unwilling to give them names of borrowers who are delinquent on these loans, though it will provide names of lenders.[248] The FmHA apparently considers guaranteed loans to be bank loans and wishes to make the guaranteed loan program appealing for banks. The FmHA currently is studying the guaranteed loan program and is concerned about the problems of FmHA "meddling" with bank loans and embarrassing borrowers by revealing their names without their written consent.[249] This is a legitimate concern, it would seem feasible and appropriate, however, for the FmHA to take measures to ensure that the parties to guaranteed loans are made aware of the availability of farmer-lender mediation.

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[246] Rural Development Act of 1972, Pub. L. No. 92-419, §128, 86 Stat. 657, 666 (1972); Food Security Act of 1985, Pub. L. No. 99-198, §1312, 99 Stat. 1354, 1524 (1985); Agricultural Credit Act of 1987, Pub. L. No. 100-233, §619, 101 Stat. 1568, 1683 (1988).

[247] U.S. Gen. Accounting Office, Farmers Home Administration: Implications of the Shift From Direct to Guaranteed Farm Loans (1989).

[248] Statements of John C. Gamble, Program Director, Alabama Farm Crisis and Transition Program; James Stovall, Jr., State Coordinator, Oklahoma Agriculture Mediation Program; and Micheal Thompson, Executive Director, Iowa Mediation Service, at CAMP meeting, St. Paul, Minn. (April 11, 1991).

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[249] Statement of Chester Bailey, Assistant to the Assistant Administrator, Farmer Programs, FmHA, at CAMP meeting in St. Paul, Minn. (April 11, 1991). Program Administrator Chester Bailey has said that "[f]ederal privacy laws do not permit us to comment on specific cases without authorization of the individual involved." Letter from Chester A. Bailey to Leonard Riskin (June 17, 1991).

In Iowa, FmHA staff reportedly assert that any requests for mediation of guaranteed loans must come from lenders. In practice, FmHA staff will not meet with guaranteed loan borrowers and lenders to resolve credit problems. This position apparently derives from a belief that such participation by FmHA would discourage banks from using the guaranteed loan program. Telephone interview with Micheal Thompson, Executive Director, Iowa Mediation Service (July 1, 1991).

## D. Two Concepts of Mediation

The farmer-lender mediation effort is infused with a tension between two different conceptions--which I will call "broad" and "narrow"--of the goals, purposes and, perhaps, very nature of mediation.[250] I define these conceptions as follows:

The broad approach assumes that the goal of farmer-lender mediation is to reach a wise agreement that deals with the underlying interests of the parties. There are any number of possible outcomes, and the process is open to discussion of whatever seems to be relevant.

The narrow approach rests on the assumption that the only appropriate focus of a farmer-lender mediation is to discuss the possibility that creditors other than FmHA will adjust the borrower's debts sufficiently to allow a rerun of the DALR$ program that will allow the farmer to "cash flow," which will permit the FmHA to offer the farmer primary loan servicing.[251] A mediation so conceived allows only two possible outcomes: the nonFmHA creditors make sufficient reductions and the FmHA offers primary loan servicing to the farmer; or, the creditors do not make sufficient adjustments and, subsequently--not at the mediation session--the FmHA informs the borrower of his other options, such as net recovery buyout, preservation financing, and voluntary conveyance of the land.[252]

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[250] The legal philosopher Felix Cohen wrote that "[a] definition of law is *useful* or *useless*. It is not *true* or *false*, any more than a New Year's resolution or an insurance policy. A definition is in fact a type of insurance against certain risks of confusion." Cohen, Transcendental Nonsense and the Functional Approach, 35 Colum. L. Rev. 809, 835 (1935). Cohen's idea applies equally to my dichotomy. For purposes of this study, I find the distinction between broad and narrow useful. Elsewhere I have applied other dichotomies--e.g. facilitating "adversarial" or "problem-solving negotiation;" "raising a fist" or "extending a hand"--to judicial settlement conferences. Riskin, The Represented Client in the Settlement Conference: The Lessons of G. Heileman Brewing Co. v. Joseph Oat Corp., 70 Wash. U.L.Q. __ (forthcoming Jan. 1992).

Other observers have deployed different breakdwons. In describing the strategies of labor mediators, Prof. Deborah Kilb identified "deal-makers and "orchestrators." D. Kolb, The Mediators (1983). Prof. Robert A. Baruch Bush identifies three conceptions of the mediator's goal: efficiency, protection of rights, and empowerment and recognition. Bush, The Mediator's Role and Ethical Standards in Mediation, 41 U. Fla. L.Rev. 253 (1989). Profs. Susan Silbey and Sally Merry identify two "ideal types" of mediation: "bargaining" and "therapy", Silbey and Merry, Mediator Settlement Strategies, 8 Law & Policy 7 (1986). And Dean James Alfini identifies three approaches, which he calls "trashing, bashing, and hashing it out." Alfini. Trashing, Bashing and Hashing It Out: Is This the End of "Good Mediation"?, ___Fla. St. L.Rev. ___ (forthcoming Summer 1990).

[251] See notes 123-28 and accompanying text, supra.

[252] See text accompanying notes 121-22, supra.

Speaking generally, the certified state mediation programs employ a broad approach. Among the noncertified programs of which I have knowledge, the narrow approach seems most common, but I have found illustrations of both approaches and of mixtures of the two approaches in the work of individual contract mediators. In addition, some FmHA representatives involved in farmer-lender mediation take the broad view and others the narrow. The dichotomy is observable also in the FmHA literature.

## 1. Manifestations of the Two Concepts

### a. "Broad" Mediation

The essence of the "broad" approach is an openness to dealing with whatever issues are important to the resolution of the difficulties between the borrower and the lenders.[253] Often this means searching for and dealing with the underlying interests of the parties through a problem-solving process that could include explicit attention to developing and understanding options.[254] Thus, the mediator might encourage the parties to think about alternatives in addition to primary loan servicing, such as net recovery buyout and lease/buyback. The mediator might help a farmer consider, or reconsider, whether to make additional changes in the farm operation or in off-farm employment, which could change the farm-home plan.[255] It also means, of course, that a mediation could deal with barriers to negotiation, such as: (1) emotional problems within the family (which could be addressed directly or through referral); (2) communication problems between borrower and lenders; and (3) disputes between lenders.[256]

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[253] For extensive explanations of mediation following a broad approach, see J. Folberg and D. Taylor, Mediation: A Comprehensive Guide to Resolving Conflicts Without Litigation (1984); C. Moore, The Mediation Process: Practical Strategies for Resolving Conflict (1986).

[254] Another way to categorize approaches to mediation is by the types of negotiation that they facilitate. The most generally useful breakdown of negotiations is "adversarial" v. "problem-solving." Menkel-Meadow, Toward Another View of Legal Negotiation: The Structure of Problem-Solving, 31 UCLA L. Rev. 754 (1984). The broad approach to farmer-lender mediation attempts to facilitate a problem-solving negotiation. It cannot be said so plainly that the narrow approach to farmer-lender mediation facilitates adversarial negotiation, but the two are philosophically consistent. See Riskin, The Represented Client in the Settlement Conference: The The Lessons of G. Heileman Brewing Co. v. Joseph Oat Corp., 70 Wash. U.L.Q. __ (forthcoming Jan. 1992).

[255] Memorandum from Don Reynolds, Chairman of Rural Assistance Corporation to Leonard Riskin , which operated the Kansas certified mediation program under a contract with the Kansas Department of Agriculture until late 1990. See R. Friedenbach, Mediation Perceptions, South Dakota Farm Loan Mediation Program (Interim Report of Evaluation Activities) (Department of Political Science, Univ. South Dakota, Dec. 1990).

This broad conception of mediation was well-developed in the first two farm-credit mediation programs--those in Minnesota and Iowa. The Minnesota program includes goals of improving "communication and relationships between farmers and lenders;" encouraging "full discussion of debt restructuring options;" and improving "the relationship among agencies and organizations working with farm families to increase profitability in agriculture."[257]

Micheal Thompson, Executive Director of the Iowa Mediation Service, also had a broad definition of success:

> -clarification of the impasses including the recognition that the issues cannot be resolved;
>
> -management of the communication system so that the parties can interact effectively;
>
> -resolution of the goals and issues...; and
>
> -reconciliation of the relationship so that both parties' interests, issues and goals are met.[258]

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[256] I do not mean to suggest that every mediation in every certified state program displayed such openness, but that this attitude seems to ground most of the certified programs and is expressed in them in varying degrees.

[257] R. Grunke and K. Magnum, Minnesota Extension Service Farm Credit Mediation Annual Report July 1, 1989 - June 30, 1990 at 3 (1990).

[258] Thompson supra note 22 at 7. The Iowa training manual emphasizes that mediation "systematically isolates points of agreement and disagreement, develops options, and works toward a final agreement;" is "oriented toward problem-solving;" and "examines facts, feelings and behaviors." Among mediation's benefits, it lists a "healing quality; and particpatory nature, which results in strong commitment bgy the disputants to adhere to the agreements reached." And it lists the following goals of mediation:

> 1. To help the involved parties resolve their conflict in a manner that is compatible with their abilities both to commit themselves to an follow through on an agreement;
>
> 2. To identify facts and feelings that personify the conflict and to establish a means for resolving the conflict without resorting to violence;
>
> 3. To encourage the involved parties to work further on those issues that cannot be resolved in individual negotiations;

A good depiction of the openness of this view is provided by Kathy Mangum, Director of the Minnesota program, in Figure 1.

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4. To identify the communication patterns that emerge during the mediation and to note the destructive behaviors that result from those patterns; and

5. To offer conflicting parties an alternative to the court system.

M. Thompson, P. West, M. Mullineaux, C. Maxwell, R. Mullineaux, J. Corder, and T. Wall, Mediation Manual for Iowa Farmer/Creditor Mediation Service 30 (1985).

**Figure 1**
*Farm Family: Basis for Decisionmaking*

| FAMILY SYSTEM | | FARM ENTERPRISE SYSTEM |
|---|---|---|
| Relationships | | Cash Flow |
| History | | Debt Servicing |
| Myths | Loyalty to Land | Expansion |
| Loyalties | | Upgrading |
| Rules | Loyalty to Family | Market Conditions |
| Obligations | | Gov't Program Options |
| | Rituals | Loyalty to Creditor Policies |
| Expectations | Tradition | Availability of Credit |
| Feelings | | |
| Shared Experiences | | |

*Farming is in Our Blood*
Dr. Paul Rosenblatt, 1990
University of Minnesota

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* Prepared by Kathy Mangum based on P. Rosenblatt, *Farming is in Our Blood: Farm Families in Economic Crisis* 69-76 (Iowa St. Univ. Press, 1990).

Stephen Erickson and Marilyn McKnight explain the importance of dealing with the emotional aspects of the farm crisis, on both sides of the negotiating table:

> The financial condition of the farmer is only one side of the problem. Most farmers have families that are directly effected [sic] by the problems. The emotional issues tend to be kept secret within the walls of the family home, and are often far more complex than the finances. The fact that the family problems are not discussed within or outside of the immediate family makes the burden sometimes unbearable for the farmer and/or his wife. The children feel the tension, and when they are not told what is happening, are left to their fantasies. They fear the loss of the family farm which includes the home, and become less attentive and uninterested in school. They may fear that their parents will divorce. It is not unusual for the wives to be kept totally in the dark about the problems, though they feel the stress of their husbands and also fear the worst. The husbands are proud and believe that they should be able to handle everything, for them to be unable to manage is admitting failure. Hence, there have been suicides of farmers, divorces, depression, and possibly delinquency or at least psychological dropping out of school by the children.
>
> It is important to realize that the lender may also experience emotional stress. The lender is often the person who helped the farmer to obtain the loans in the first place, and may feel some responsibility or guilt about the present state of affairs. The lender is usually a well respected member of the community, and may be plagued with depression about what is happening to the entire community, his friends, and those with whom he worships in the same church on Sundays. Some lenders have found themselves ostracized by those close to him because of his role in the rural finance crisis.
>
> The mediator of farm issues needs to understand the emotional side of the problem. Both the farmer and the lender may be experiencing the anticipation of a loss, be it

> the farm or close friends. Their process of dealing with the loss is similar to that of grieving a death.[259]

In the broad view of mediation, the "emotional side" has at least two aspects. First, a mediator must be able to help the parties deal with their emotional difficulties to the extent necessary to allow them to make decisions required to resolve their financial problems and to enable them to operate the farm profitably so as to fulfill loan obligations. At a minimum, a mediator might show empathy by acknowledging the emotional difficulty the client is facing. At the other extreme, the mediator might help the participant (normally the farmer) think through whether he needs other assistance, say, from a counselor (psychological, financial, agricultural) or a divorce lawyer. Of course, it is common in farm credit delinquency situations for emotional difficulties to impair relationships and communications between borrowers and lenders, or, more commonly, lender's representatives. Accordingly, mediators with a broad perspective structure the mediations so as to allow the participants to work to improve or repair their relationships or communications. This often will involve an emphasis on face-to-face discussions between borrower and lender, rather than the private meetings or "caucuses" between the mediator and the participants, which tend to characterize the narrow approach.[260]

Second, the emotional difficulties--particularly as they are manifested in impaired relationships--can take on a special significance. In a broad mediation these issues can be seen as more than barriers to resolution of financial problems. Relational problems between borrower and lender can themselves become issues in the mediation. And resolution of those issues has a value that is independent of whether the mediation results in a satisfactory conclusion with respect to the delinquent loans. Such resolutions can also improve the quality of life in a community.

Certified programs generally have taken a broad approach. For example, Robert Friedenbach asked South Dakota mediators to identify their "primary objective;"[261] a majority of responses indicated an open orientation, and several showed particularly strong forms of it:

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[259] S. Erickson and M. McKnight, Farm Financil Mediation 57-58 (4th Ed., Univ. of Minnesota Extension Service, 1987).

[260] Text accompanying notes 276-80, infra.

[261] R. Friedenbach, Mediator Perceptions, South Dakota Farm Loan Mediation Program (Interim Report of Evaluation Activities) 29 (Department of Political Science, University of South Dakota, Dec. 1990).

> Encouraging participants to be aware of communication's possibilities & consequences--to aid parties in identifying & modifying disruptive communication.
>
> To bring farmer & banker to the point of hearing the other even if they don't 'agree.' To acknowledge [the stories] of both as equally important. To, hopefully, help them 'settle' with a realistic agreement. To show them that yes, it is their problem but if we make it 'our' problem it becomes easier to develop options and eventually a settlement.
>
> To promote communication between creditor and debtor and to see that all possible options and alternatives have been discussed and considered. Once this has been done I try to help them resolve their differences.[262]

The broad approach generally emphasizes encouraging and empowering the participants to make their own Accordingly, programs using a broad approach tend to provide extensive help to farmers in preparing for and, in some states, participating in, mediations. Thus, both mediators and participants normally spend more time in preparing for and participating in these mediations than their counterparts in narrow mediations.[263]

For example, as previously stated, the Kansas mediation program is connected with the Farmers Assistance Counseling Training Service (FACTS), part of the Kansas State Board of Agriculture, which provides farmers extensive financial and legal counseling in connection with the mediation. The goal of this program is for the parties to reach agreement as to how they will resolve the major issues in one 4-hour session, which has been preceded by extensive submissions of information to the mediators. The outcome is embodied in a document called a "Basic Understanding."[264]

Kansas mediators average about 5 hours preparing for, conducting, and wrapping up each mediation, plus travel time.[265] In addition, Farm and Ranch Mediation Service (FARMS), the unit of the Rural Assistance Corporation that operated the mediation program until late 1990, employed "processors"

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[262] Id.

[263] Note however, that in both certified and noncertified states, borrowers may retain the services of farm financial consultants or lawyers to help them prepare for or participate in mediations.

[264] Id.

[265] Telephone interview with Don Reynolds, Chairman of the Rural Assistance Corporation (April 5, 1990).

(neutral financial specialists, not mediators) who solicited and interviewed participants before the face-to-face meetings and prepared a written overview of the financial situation. They put in 3 to 4 hours per mediation.[266]

Mediators in Minnesota[267] spend an average of 10 hours per mediation; 75 percent of that time is devoted to mediation sessions and the remainder is in preparation, correspondence and telephone calls.[268]

In the Iowa program, a mediation coordinator spends an average 4 to 5 hours orienting the parties to the mediation process and, where appropriate, referring the farmer to additional sources of assistance--such as lawyers and financial specialists--and 2 hours in follow-up activities. The mediators average almost 3 hours in mediation, but one case took 8 hours, another 40.[269]

Mediators in South Dakota report that they spend an average of 2.3 hours in mediation sessions and 3.3 hours in preparation and follow-up activities, including travel.[270]

### b. "Narrow" Mediation

Under a "narrow" view of the purposes of farmer-lender mediation, the principal--and sometimes the exclusive--issue is whether the creditors will adjust their debts so that a rerun of the DALR$ program would show a feasible plan, which would allow the FmHA to provide primary loan servicing so that the borrowers could continue farming, and owning, the land.[271]

A number of directors of certified state mediation programs have indicated that some of the FmHA representatives in their states held this view so strongly that it severely limited FmHA's participation in mediations. In some noncertified programs, this narrow view of mediation not only dominated FmHA's participation, but also controlled the outlook of the mediators.[272]

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[266] Telephone interview with Don Reynolds, supra note 263. Earl Wright of the Kansas Board of Agriculture states that these individuals, charged with gathering information, were neither neutral nor financial specialists. Memorandum to the author from Candace Fowler, Administrative Conference of the United States (Nov. 7, 1991).

[267] Telephone interview with Kathy Mangum, Farm Credit Mediation Program Director, University of Minnesota Extension Service (Sept. 20, 1990).

[268] Id. (Sept. 21, 1990.)

[269] Telephone interview with Micheal Thompson, Executive Director, Iowa Mediation Service (May 30, 1991).

[270] R. Friedenbach, supra note 261 at 3.

[271] See Section II.A.2, supra.

[272] I cannot say that this was the situation in all noncertified states in which FmHA contracted for mediation services. There is no way, within the confines of this study, to gather such information on all such FmHA efforts. In several state FmHA programs of which I have knowledge, however, this narrow view seemed to predominate. As a consequence, the mediation

The mediations under these programs tended to be much shorter and more formulaic than under certified state programs.

One example of the narrow approach in noncertified states is the mediation model developed and promoted by Ted W. Spiegel, Executive Director of United States Arbitration and Mediation Midsouth, Inc. of Louisville, Kentucky (U.S. A. & M. Midsouth). U.S. A. & M. Midsouth has had contracts with the FmHA to provide mediation in Kentucky, North Carolina and Tennessee and, at this writing, operates under contracts with FmHA in Kentucky and Tennessee.[273] The process was limited to debt reduction by nonFmHA creditors.[274] It employed a highly structured format[275] that allowed significantly less room than would a broad approach for problem-redefinition, option development, or direct communications between the borrower and the lenders. Spiegel believes--understandably, as I shall illustrate below--that mediation between the farmer and the FmHA is "prohibited by the regulations."[276] Under this format, before each mediation, the mediator obtains the DALR$ program and sets a goal for debt reduction by nonFmHA creditors that would allow the farmer to qualify for primary loan servicing.[277]

The mediator--either Spiegel or a person he had trained--begins with an opening statement and does not allow the farmer to "say anything to all the

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services provided under such programs had goals that were significantly narrower than the goals of most of the certified state mediation programs.

[273] U.S. A. & M. Midsouth is a Kentucky corporation and an independently owned and operated affiliate of United States Arbitration and Mediation, Inc., a Washington corporation headquartered in Seattle. Telephone interview with Ted W. Spiegel, Executive Director, United States Arbitration and Mediation, Midsouth, Inc., Louisville, Ky. (Jan. 29, 1991).

[274] The notice sent to the farmer under this program provides ."..a mediation session and meeting of creditors has been scheduled for the purpose of discussing settlement of your farm and nonfarm debt which is not directly owed to the USDA-Farmers Home Administration." U.S. Arbitration & Mediation Midsouth, Inc., Technical Proposal submitted to the FmHA North Carolina office at 55 (undated; transmitted with letter from Ted W. Spiegel, Executive Director, United States Arbitration & Mediation Midsouth, Inc., to Leonard Riskin (March 18, 1991) (emphasis supplied).

[275] Telephone interview with Ted W. Spiegel, supra note 275.

[276] Id.

[277] Id. The mediator also makes sure that the farmer understands foreclosure and that the farmer would need a lawyer if foreclosure were initiated.

In contrast, mediators using a broad approach in Iowa would often mediate over issues of what figures should be used in the DALR$ program. Telephone interview with Micheal Thompson, Executive Director, Iowa Mediation Service (July 1, 1991). In other words, while under Spiegel's approach, the mediator accepts the outcome of the DALR$ program, under the broad approach used in Iowa, the mediator allows the farmer and the FmHA representative to negotiate over the appropriate input into the DALR$ program.

people in the beginning"[278] because he "does not want to embarrass the farmer, does not want him to appear to be begging. Everyone knows what the farmer wants."[279] After the opening statement, the mediator meets with each nonFmHA creditor privately. In these sessions, he "stresses compassion and confidentiality."[280] He keeps the creditors separate and asks them to give concessions, not knowing what the other creditors will do. "If that fails," Spiegel said, "I ask them to give contingent concessions."[281] When he develops "something that looks like it might work," he calls the farmer back in.[282]

Spiegel allocated 2 hours for each mediation, but some were completed in just 15 minutes.[283]

Other units of U. S. Arbitration and Mediation won contracts with FmHA to provide mediation in other states.[284] And Spiegel's model, which is consistent with U.S. A & M, Inc.'s approach to mediation in personal injury insurance claims, has influenced the conduct of mediation by at least some of these other units. For instance, mediators in local affiliates of U.S.A & M, Inc. that secured mediation contracts with the FmHA in Missouri in 1988 were highly influenced by the model developed by Spiegel;[285] thus, they believed, for example, that 2 hours typically was ample time for a mediation. One of the mediators almost always completed mediations in less than an hour and was able to conduct some mediations in just a few minutes each.[286] Another, who conducted about 30 mediations--all but one of which resulted in restructuring--generally spent 45-60 minutes in mediations, following roughly 30 minutes of telephone contacts with nonFmHA creditors.[287] Both of these mediators believed that all parties generally left mediations feeling pleased. It is important to recognize that although narrowly focused mediations generally pay less explicit attention to interpersonal aspects of the situations they are dealing with, such processes may have the effect of improving feelings and relations.

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[278] Id. Other mediators who practice a narrow approach do offer the farmer an opportunity to make a statement in the beginning. Telephone interview with Judge Laurie Smith, mediator with U.S. Arbitration and Mediation, Midwest, St. Louis, Mo. (May 29, 1991); telephone interview with Lawrence J. Robertson, mediator with U.S. Arbitration and Mediation, Midwest, St. Louis, Mo. (May 30, 1991).

[279] Id.

[280] Id.

[281] Id.

[282] Id.

[283] Id.

[284] The Washington state office of United States Arbitration and Mediation has contracted with the Washington State FmHa to provide mediation services. Id. Two Missouri affiliates have had contracts for portions of Missouri. Telephone interviews with Carolyn Crowe, Director, United States Arbitration and Mediation Midwest, Inc., St. Louis, Mo. (May 9, 1990) and Richard Routman, President, Midwest Arbitration and Mediation, Inc., Kansas City, Mo. (April 5, 1990).

[285] Interview with Carolyn Crowe, Director, U.S. Arbitration and Mediation Midwest, Inc., which provided mediation services in parts of Missouri under contract with the FmHA in 1989 (May 9, 1990). Spiegel advised other "office-holders" of opportunities to obtain farm credit mediation contracts with FmHA, and he informed them of the approach to farm credit mediation that he developed. Id. Richard Routman, President of Midwest Arbitration and Mediation, Inc., Kansas City, Mo., which provided mediation in 1988 under contract with the FmHA in Missouri, stated that these mediations were "not necessarily" modeled on Spiegel's and always took at least 90 minutes. Telephone interview with Richard Routman (July 2, 1991).

The emphasis on gaining concessions from the nonFmHA creditors shown in these mediations leads me to question whether either the farmer or the FmHA are really "participating" in such mediations or are just attending them. (As explained above, the obligation to mediate imposed by the Agricultural Credit Act upon the Department of Agriculture applies only to certified state mediation programs.[288])

Although the narrow approach generally has an ideological base, sometimes mediators who begin with such an approach will broaden it in response to perceived needs of the parties. Thus, mediators in the local affiliate of U.S. A & M. in Kansas City, Missouri reportedly have mediated crop changes in the farm-home plan, and "would have" mediated a smooth transition off the land if that had been desired by a farmer.[289]

Another example of a narrow approach was that employed by the Federal Mediation and Conciliation Service. Although its training programs apparently included a problem-solving orientation, which is almost synonymous with a broad approach to mediation,[290] in conducting mediations in several noncertified states the FMCS seemed to accept unquestioningly severe limits on the scope of mediation.[291] But the FMCS mediators apparently went a step further than their counterparts at U.S. Arbitration and Mediation. After determining that the nonFmHA creditors could not make sufficient adjustments, the FMCS mediators tried to persuade the farmer to sell the land. In the words of FMCS Commissioner Ira Lobel of Albany, New York:

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[286] This mediator, who once conducted six mediations in 2 days, told me that, although the mediations were scheduled at roughly 2-hour intervals, she never spent 2 hours conducting a mediation, though she often spent up to 1 hour preparing. Telephone interview with former judge Laurie Smith, a neutral with U.S. Arbitration and Mediation Midwest, Inc., St. Louis, Mo. (May 30, 1991). One case took about 1 hour; two cases, in which the farmer and the nonFmHA creditors had already worked out an arrangement, took 5 to 10 minutes; cases in which she quickly determined there was no chance of sufficient adjustments in debts took 10-30 minutes, because she made sure to give the farmer an opportunity to "have a forum." Judge Smith always gave the farmer the opportunity to make a statement if he wished, though usually the lawyers "had the case well in hand and the farmer just answered questions." Id.

[287] Telephone interview with Lawrence J. Robertson, mediator with U.S. Arbitration and Mediation Midwest, Inc., St. Lousi, Mo. (May 30, 1991).

[288] Note 61, supra and accompanying text.

[289] Telephone interview with Richard Routman, President, Midwest Arbitration and Mediation, Inc., Kansas City, Mo. (July 2, 1991).

> In the states we have mediated cases--New York, Vermont, and Maine--the farms are small, often under $100,000 in total farm indebtedness and under $50,000 yearly income...
>
> While the small farms, in and of themselves, are not a detriment to mediation, there are some practical implications of small farms that have a negative effect on the mediation process. First of all, in most cases, the FmHA is the primary lien holder. Under FmHA programs, they have investigated many financing alternatives before the mediation step ever takes place. Secondly, other creditors are usually so small in both number of creditors and dollar amount that there is not sufficient flexibility to allow for a restructuring of the debt.
>
> The impact of the "small farm syndrome" is that in New York, Maine and Vermont...very little mediation takes place, in the traditional use of the term. The FmHA does a great deal of the financial work before it ever gets to the mediation step. Since FmHA holds most of the secured debt on the property and since their programs require them to delineate the various restructuring options available to the farmer, they have already indicated all their flexibility before the mediation ever occurs. The other lienholders usually do not have sufficient loans outstanding in which a restructuring of the payback will have any impact on the farmer's ability to continue operating with a positive cash flow.

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[290] Memorandum from John A. Wagner, Director, Mission Support, Federal Mediation and Conciliation Service to dispute resolution trainers , re: Farmer/Lender Dispute Resolution Training Programs, with attached training materials (1989).

[291] Lobel, Farmer-lender Mediation, Dispute Resolution and Democracy, Proceedings of the 17th Annual Conference of the Society of Professionals in Dispute Resolution 199, 200 (1989).

> The ability of a mediator to be creative at this stage is extremely limited, since there is simply not sufficient dollars or creditors to be creative in settlement. (Parenthetically, I know from my own labor experience some of the most difficult cases are those single issue cases where the settlement is all one way or the other).
>
> Accordingly, the actual mediations, in nonmandatory states such as New York, Vermont, and Maine, where the farms are small and creditors are few, have been a vehicle to convince farmers that they must sell part of their land, which, while it may not be a desirable end result, does make for a successful mediation--an agreement that will avoid foreclosure. Being the outside expert, mediators have been able to convince farmers that a land sale was their only alternative.[292]

My own experience with the contrast between narrow and broad approaches to mediation, though assuredly not typical, illustrates one difference in practice.

In 1987, well before I undertook the present study, I conducted two farm credit mediations for FmHA contractors who generally operated under a narrow view of the purposes of these mediations. At one of these sessions, the only persons in attendance were the farm couple, the FmHA county supervisor, and me; none of the several nonFmHA creditors appeared. Accordingly, it was plain that the session could not produce adjustments in nonFmHA debt, which, I had been informed, was the purpose of the mediation. Had I followed one of the narrow conceptions of mediation, I would have ended the session immediately; had I followed a different conception of narrow mediation, I would have let the farmer talk about his problems or tried to persuade him to give up the farm.

But I believe it is generally appropriate for a mediator to help the parties define their difficulties as broadly as they wish. So I spent the next 3 hours mediating, not "the debt," but the situation. In the joint session, the farm husband proudly asserted that he wanted to keep the farm and that he could improve his farming sufficiently to make his payments to FmHA--even if the DALR$ program indicated the contrary. The FmHA supervisor concluded that he was bound by the outcome of the DALR$ program. In private caucuses, I was able to get behind these public postures. I learned that the farmer had decided to give up farming but wanted to keep his homestead and

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[292] Id. at 201-202.

160 acres. However, he had never communicated this to the FmHA supervisor, largely because of anxiety, depression, and confusion as to his options.

Next, I learned that the FmHA supervisor was unwilling to lend the farmer additional money or to restructure the debts. He felt extremely tense and guilty, however, about the possibility of running this family off the land, and he wanted to be as cooperative as possible. But he believed the farmers were not being open with him.

I brought them back together to exchange this information, and to discuss options, including bankruptcy. It became plain that both parties needed this discussion to understand their own and one another's situation. The farmer and the FmHA representative reached no specific agreement about how to treat the delinquent loan. Instead, the farmer agreed to keep the FmHA supervisor apprised of his plans, including the possibility of bankruptcy. And the FmHA supervisor promised to give the farmer as much time as possible before the FmHA moved against the property. But there were other, more subtle outcomes: The session greatly reduced the tension between the participants, and it laid the groundwork for future cooperation and communication.

### c. Effects of the Divergence in Approaches to Mediation

The divergence in views on the proper approach to mediation has manifested itself in several ways. First, as already indicated, the nature of the mediations typically conducted under certified programs differs greatly from those conducted in at least some contract mediation programs. Second, in some certified states, at some times, while mediators yearned or pushed for a broad approach, FmHA representatives at mediations clung to the narrow view, believing or maintaining that they had no authority to discuss options other than primary loan servicing, and that the DALR$ program was the only avenue toward that approach.[293] At CAMP meetings, directors of state certified mediation programs have reported difficulties resulting from such restricted participation by FmHA, including resentment by other creditors of FmHA's inflexibility. They stressed that the mediation process could be improved if more discretion were vested in FmHA representatives. However, some of these state program directors also reported that many FmHA representatives were willing, sometimes "with some nudging," to interpret their mandates generously.

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[293] There are, of course, many individual variations.

In Wisconsin, our Farm Mediation and Arbitration Program takes the "broad" approach to mediation. This approach sometimes conflicts with the "narrow" approach to mediation taken by the FmHA State Director, and many FmHA County Supervisors. On the other hand, the State FmHA Mediation Coordinator and many FmHA County Supervisors take a more expansive view towards mediation, while other FmHA County Supervisors can be "nudged" toward a "broad" view of mediation. Conflict between the "broad" and "narrow" approach to mediation in Wisconsin, particularly in FmHA cases, affects outcomes of cases as well as the parties' perceptions of the success (or failure) of the mediation process.

Memorandum from Dennis P. McGilligan, Coordinator, Wisconsin Farm Mediation and Arbitration Program to Charles Pou, Jr., Administrative Conference of the United States (Oct. 31, 1991).

Third, in noncertified states, some contractors who were imbued with a broad mediation vision may have spent much more time as mediators--in preparing, conducting and following up--than they or the FmHA anticipated. One example is Jack Dawson, whose firm was awarded a mediation contract by the FmHA Colorado state office in 1990, under which it was paid $200 or $240 per case, all inclusive, depending on difficulty of travel.[294] He submitted such a low bid in the belief, which he still holds, that this was the only way to win a contract. But because Dawson subscribes to a broad notion of mediation, he spent an average of 14 hours on each case, which meant an hourly rate of about $14.30. Before each mediation, he devoted a good deal of time to educating the participants about options and referring them to support services or providing such services, functions outside his official mandate. He also helped some farmers deal with the FmHA months after the mediation ended. An experienced lawyer, Dawson rationalizes this by considering that he donates some of his time.[295]

Like several certified state program directors, Dawson reported that at first FmHA representatives had a very narrow view of the goals of mediation, but that once he realized that the mediations "were his shows to run," he found the FmHA officials responsive to discussion of underlying interests.[296]

### d. Advantages and Disadvantages of Each Approach

Each approach to farmer-lender mediation has its own internal logic and advantages and disadvantages. The narrow approach accepts the definition of the problem that is implicit in FmHA rules: will nonFmHA creditors adjust their debts sufficiently to allow primary loan servicing? The broad approach seeks out underlying interests and works with the parties to define the problems and identify options as broadly as they wish. Thus, the narrow approach is more predictable and, in a sense, efficient. The objective is clear, the types of outcomes limited. It demands less involvement of the participants. All concerned spend less time, so the costs to the government and to participants should be lower, though neither I nor, so far as I know, the FmHA, have attempted this calculation. If the burdens of participation are lower in narrow mediations, perhaps some borrowers and lenders would find participation more appealing.

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[294] Telephone interview with Jack Dawson, Director, Conflict Resolution Resources, Boulder, Colo. (Feb. 5, 1991).

[295] Id.

[296] Id. The contract mediator in Ohio has expressed a frustration with the narrowness of mediations conducted at such a late stage in the loan servicing process, but has noted, as did Jack Dawson, that sometimes FmHA representatives are willing to "go along with" the mediator. Telephone interview with Benne Straughn Herbert, President, Arbitration and Mediation Services, Cleveland, Ohio (March 5, 1991).

On the other hand, the narrow approach may cause all concerned to miss opportunities to develop solutions that will meet the needs of the parties and to improve relationships and communications. It can provide a convenient myopia for a FmHA representative who has decided against primary loan servicing.

The broad approach offers the opportunity to develop a diverse array of problem-solving solutions that better meet the parties' actual needs. Where this is effective, it produces superior results. In such cases, the broad approach has a bigger payoff than the narrow. Potential disadvantages of broad approach are that it can demand more of the time and energy of all concerned and may call for some interpersonal skills in the mediation that are less necessary in the narrow approach.

## 2. Why The Two Concepts Developed

### a. The Disparity Between Certified and Contract Mediation Programs

It is easy to see why the broad mediation conception developed more readily in certified state mediation programs than in some of the mediation programs that were created in noncertified states through contracts with FmHA state offices. The two kinds of programs were created and developed quite differently. Many of the certified programs were launched before FmHA began participating in farm credit mediation in 1988. Creditors with whom the programs dealt did not have the kind of rigid requirements for adjusting loans that govern the FmHA. The programs often grew out of efforts that had strong community and high level political support. Many of the people who became mediators in such programs did so on a semi-volunteer basis (i.e., for small fees, and had strong connections to the agricultural sector and to rural communities).

Thus, many of the leaders of these programs began with concerns not just to keep farmers on the land, but also to help farmers--and rural communities--cope with economic and social deterioration. These concerns, as well as the mediation philosophies of the leaders of these groups, helped shape a broad concept of mediation. The Iowa and Minnesota mediation programs, the first and probably the largest, became prototypes for most of the other certified programs, though all of the certified programs differed from them in significant ways.[297]

Thus, the certified programs developed their own concepts of mediation in response to concerns, such as those listed above, and the Agricultural Credit Act of 1987 directed the FmHA to participate in those programs. In contrast, in the noncertified states, the FmHA set the terms for mediation.

And in setting out the terms for mediation in the noncertified states, the FmHA has shown a deep and understandable ambivalence. Recall that the Agricultural Credit Act of 1987 requires the FmHA to participate only in the mediations offered by certified state programs.[298] It does not direct FmHA to offer or participate in mediation in other states. The statutory basis for the contract mediation program is a requirement that the FmHA make "a reasonable effort" to contact and encourage creditors to take part in a restructuring plan.[299] In addition, implementation of a broad form of mediation is more time consuming and expensive, and the certified programs generally were better funded.

### b. Within the FmHA

One reason why a narrow concept of mediation evolved in some FmHA offices is the place assigned to mediation in the FmHA's procedures for reviewing the status of delinquent borrowers. Under the FmHA's rules, the delinquent borrower is officially notified of the mediation option only after the FmHA has determined--normally through the DALR$ program--that the farmer is ineligible for primary loan servicing.[300] Many FmHA officials apparently feel that at this stage, their only option is to attempt to arrange for other creditors to adjust their debts, and to do this through a mediation or a voluntary meeting of creditors, both of which they see as limited to such narrow purposes.

According to program administrator Chester Bailey, the FmHA located mediation late in the loan servicing process for two reasons: (1) comments from farm advocacy groups that feared that if mediation occurred earlier, the FmHA might use mediation to delay carrying out its obligation to restructure if the borrower met the statutory criteria, and (2) FmHA's perception that some lenders would not want to participate in a mediation if they thought there was still a chance that the farmer's situation could be improved by FmHA restructuring.[301] Mr. Bailey does not object to timely, broad, professional mediation and believes that mediation should occur earlier in the loan servicing process with all concerned creditors.[302]

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[297] The directors of the Iowa and Minnesota programs, Micheal Thompson and Kathy Mangum, conducted numerous training programs for FmHA personnel and for mediators in both certified and contract mediation programs. See text accompanying notes 197-201, supra.

[298] Agricultural Credit Act of 1987, §501-512, 7 U.S.C. §§5101-5106, 2006, 12 U.S.C. §2202e (1988).

[299] Agricultural Credit Act of 1987, §615(d)(2), 7 U.S.C. §2001(d)(2) (1988).

[300] See Section III.A.2.

Yet the narrow vision is reinforced by several official FmHA pronouncements, including the notice sent to the farmer, which suggests just one purpose for the mediation, an attempt to persuade other creditors to adjust the farmer's debts:

> If you cannot show a feasible farm plan because you owe too much to other creditors and suppliers, FmHA will help you try to get your other creditors to adjust your debts. This will be done by FmHA asking for mediation if your state has mediation programs approved by the Department of Agriculture. If there is no state mediation program, FmHA will try to set up a meeting with your other creditors and suppliers.[303]

On the other hand, some FmHA statements appear to acknowledge a reasonably broad notion of mediation. The Report to Congress of December 1989, for example, explains mediation as follows:

> Once the parties are assembled, the mediator confirms that all agree to a few simple ground rules. Each tells his or her story to ensure that all points of view are covered. The mediator then helps the parties identify information that might be needed to evaluate the situation, sources of expertise, and steps to be taken. Options are developed and

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[301] Interview with Chester A. Bailey, (May 15, 1991).

[302] Telephone interview with Chester A. Bailey, Assistant to the Assistant Administrator, Farmer Programs, FmHA (May 15, 1991). Letter from Chester A. Bailey to Leonard Riskin (June 17, 1991).

[303] 7 CFR Pt. 1951, Subpt. S, Exh. A, 184, 186 (1991).

An FmHA instruction to field offices on participation in mediation gives only one basis for the development of a feasible plan that: "[t]he borrower's other creditors agree to make adjustments to their loans so that a feasible plan can result." FmHA, Module Six: How to Participate in Mediation or Voluntary Meeting of Creditors (undated).

The narrow approach also is reflected in proposed rules published just before this report was completed. Farmer Program Account Servicing Policies for Section 1816 and Other Related Section of the "1990 FACT ACT," 56 Fed. Reg. 54970, 54988 (1991) (to be codified at 7 CFR §1951.909).

> recorded so each can be considered and a narrowing down of the options began.
>
> Preliminary agreements are reached about which possibilities might work and which should not be discussed further. The farmer and the creditors might talk with others. Caucuses might be called. Finally, the mediator helps the parties put all of their agreement in writing, sign, and made available to all participants....
>
> The mediator does not hold evidentiary hearings as in arbitration. The parties are invited to come to the mediation conference prepared with all of the evidence and documentation they feel will be necessary to discuss their respective cases. The mediator gathers the facts and clarifies the discrepancies and acts as a neutral third party and assists the parties in exploring alternatives that the borrowers and creditor(s) might not have considered on their own.[304]

This is a description of the kind of mediation that the FmHA believed took place under the certified state programs, a relatively open process. When the report talks about developing options, it must recognize that there are alternatives other than primary loan servicing.[305]

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[304] 1989 Report to Congress 3 (1989).

[305] Notice also that the FmHA's objectives may differ somewhat from the objectives of certified state mediation programs, such as those in Iowa and Minnesota. See text accompanying notes 258-68, 292, supra.

According to the 1989 Report to Congress,

> USDA lenders participate in the mediation process with three primary goals:
>
> 1. to explore all options to keep the family in farming,
>
> 2. to work with the farmer and other creditors to develop a plan which will benefit the borrower and the creditors, and
>
> 3. to make the process of debt reorganization more efficient by reaching an agreement, which can reduce the number and length of reviews and appeals.

1989 Report to Congress, supra note 136 at 3.

And a broad, open, notion of mediation also appears in the FmHA rules: "the purpose of mediation is to participate with farm borrowers, and their creditors, in an effort to resolve issues necessary to overcome the borrower's financial difficulties."[306]

In one sense, the FmHA has tried to make the contract mediation services comparable to the mediation services provided by certified programs.[307] The brochures describing the two programs would give no hint of a substantive difference.[308] But the FmHA has given certified programs great leeway in the conduct of mediations and--deliberately or not--may have imposed limits on the way in which contract mediators defined their tasks.

The contracting process also may have encouraged the development of narrow mediations. In this process, the FmHA generally spoke the language of broad mediation in seeking contractors, but frequently wound up with narrowly-focused mediations.

An initial step in the contracting process was the issuance of a memorandum in January 1989 by Neal Sox Johnson, FmHA Acting Administrator, to all State Contract Program Managers.[309] This included an example for "guidance only" of a "request for quotation (RFQ) for mediation services" and appears to have been used and followed by FmHA offices in numerous states. The example provides that the contractor will "provide mediation services for farm borrowers who are experiencing financial difficulty," under an "Indefinite Quantity Fixed-Price contract." Among the responsibilities of the mediator are making arrangements for scheduling meetings, and the following, which seems to contemplate some elements of a broad mediation:

> At the mediation session, the mediator will describe the procedures and ground rules covering each party's opportunity to talk, order of presentation, decorum, discussion of unresolved issues, use of caucuses and

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[306] 7 CFR §1951.912(a) (1991).

[307] Memorandum from Glenn J. Hertzler, Jr., Assistant Administrator, Farmer Programs, FmHA to Michael J. Wilkerson, Deputy Administrator, Program Operations, (Sept. 26, 1988); telephone interview with Chester A. Bailey (July 12, 1990).

[308] Farmers Home Administration, FmHA Farmer-Creditor Mediation, A Guide for Use in States With Certified Agricultural Mediation Programs (Program Aid 1455, 1989) (Brochure) and Farmers Home Administration, FmHA Farmer-Creditor Mediation, A Guide for Use in States Without Certified Agricultural Mediation Programs, (Program Aid 1454, 1989) (Brochure). In fact they are written in such a way that either kind of mediation might be acceptable.

[309] Memorandum from Neal Sox Johnson, Acting Administrator, FmHA, to All State Contract Program Managers, re: Contracting for Mediation Services (Jan. 12, 1989).

> confidentiality of proceedings. Mediation sessions will be conducted in private...
>
> The mediator will lead and manage the discussion as a neutral without making decisions or judgements. The mediator's job is to insure that **all participants** in the mediation get to **speak and be heard, help define the issues, emphasize common goals**, keep discussions focused, facilitate discussion of **all items and sources of assistance** and reduce fault finding. During the mediation session, the mediator is responsible for keeping things orderly, fair and moving forward.
>
> The mediator will advise, counsel and assist the parties on ways to come to agreement but will not tell the parties how they should conduct their business or personal affairs...
>
> As necessary, the mediator will meet with each party in caucuses. The mediator will clarify each party's version of the facts, priorities, and positions, loosen rigid stances, **explore alternative solutions, and seek possible tradeoffs**. The mediator will probe, test, and challenge the validity of each party's position. The mediator will not serve as an advocate but as an "agent of reality." The mediator must make each party think through its demands, priorities and views, and deal with the other party's arguments.[310]

The document also described the basis for award:

> "(a) The government will award a contract resulting from this solicitation to the responsible offeror whose offer conforming

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[310] Id. at 2. (emphasis supplied) The document also contains directions to parties in preparing for the mediation, including identification of their own needs, interests, and priorities, and the following:

> determine course of acting, positions, and tradeoffs and explore a variety of possible solutions:
>
> -initial proposal (what one wants most, high enough to allow room to negotiate)
> -fallback proposal (alternative proposal that would be acceptable)
> -bottom-line proposal (final option that one absolutely must have)

Id.

> to the solicitation will be most advantageous to the government, cost or price and other factors, specified elsewhere in this solicitation, considered."[311] Another provision allowed the government to "accept other than the lowest offer."[312]

The document provided for a 100 percent, total set aside for small businesses.[313] It suggested asking for contractor's qualifications, including farm finance mediation training; education in management, finance, "real estate, teaching or seminary;" and abilities to apply knowledge to cases, to be neutral, to manage conflict, to "inform, strategize, negotiate, and follow through." And it set out the factors to be used in evaluating the proposals as follows:

1. Performance Factors

| **Criterion Category** | **Weight** |
|---|---|
| Experience of the person or firm and the personnel expected to perform the work. | 50 points |
| Evaluation of the training received. | 30 points |
| References from individuals for whom the offeror has performed similar work. | 20 points |
| | 100 points[314] |

It is beyond the scope of this report to gather or analyze the contracting procedures employed by all FmHA state offices. I will explain the procedure used by the FmHA Tennessee office, however, because that seems to be the first office to have embarked upon the contracting process; its forms were widely circulated and, I believe, its practices widely followed.

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[311] Id. at 10.

[312] Id. at 10. Recent legislation allows federal agencies to agree to compensate neutrals on a basis that "is fair and reasonable to the government." Administrative Dispute Resolution Act of 1990, Pub. L. No. 101-552, §583(e), 104 Stat. 736 (1990).

[313] Id. at 11.

[314] Id. at 13.

The process began with the publication of pre-solicitation notices in local newspapers stating that the FmHA would require the services of a mediator and asking interested persons to submit resumes.[315] They received 180 resumes. From that group the FmHA identified those with "legal or financial background" and sent them a Request for Quotation based upon the model distributed by Neal Sox Johnson. The bids consisted of two parts--a price quotation and a technical proposal. Then a panel, which was unaware of the price quotations, rated each technical proposal in accordance with a rating scale based on the scale set out in Mr. Johnson's document. At that point, the contracting officer determined a minimum number of points required to be qualified. From the group that was qualified, he chose the bidder with the lowest price proposal.[316]

For the first round of contracting, the FmHA state office for Tennessee divided the state into three regions and awarded the contracts for two of the regions to the same bidder. In subsequent solicitations and contracts, it treated the entire state as one region.[317]

I am aware of a wide range of prices paid for contract mediation services. The contract mediator in Colorado receives $200 per mediation and $240 for cases that require travel to less accessible regions.[318] These figures include expenses. Organizations that had contracts with FmHA in Kentucky, North Carolina and Tennessee received a flat fee ranging from $375 to $675, depending on travel time.[319] One of the early contractors in Missouri received $500 per case,[320] which included travel and any other expenses.

Most of the successful bidders to whom I spoke believed--both before and after they were awarded contracts--that, aside from minimal qualifications, price either was, or was almost, an overriding consideration in the award of contracts. It is difficult, however, to determine to what extent this emphasis on cost might have contributed to the use of a narrow approach by contract mediators.

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[315] Telephone interview with Robert Heatherly, Contract Program Manager, FmHA State Office, Tennessee (April 1, 1991).

[316] I believe that a similar process was followed initially by the FmHA in Missouri, though the contracting officer in that state felt less constrained to award the contract to the lowest bidder. Telephone interview with Lue Lockridge, Contract Specialist, FmHA State Office, Missouri (May 12, 1991).

The contract mediator in Ohio believes that the process there relied more heavily on qualifications than price. Telephone interview with Benne Straughn Herbert, Cleveland, Ohio (March 5, 1991).

[317] Telephone interview with Robert Heatherly, supra note 317.

[318] Telephone interview with Jack Dawson, Director, Conflict Resolution Resources, Boulder, Colo. (Feb. 5, 1991).

[319] Telephone interview with Ted W. Spiegel, Executive Director, United States Arbitration and Mediation Midsouth, Inc., Louisville, Ky. (Jan. 29, 1991).

[320] Telephone interview with Richard Routman, Director, Midwest Arbitration and Mediation, Inc., Kansas City, Mo. (April 5, 1990).

In 1988, the FmHA state office for Missouri arranged for a farmer-lender mediation training to be provided by Micheal Thompson of the Iowa mediation program. An official of an organization that was awarded a contract in that state, and who attended that training workshop, told me that she felt that the Iowa model was inapplicable in Missouri given the small amount of money available.[321] In addition, the bid she submitted had been based on the narrow conception of farmer-lender mediation.[322]

I cannot conclude, however, that the cost pressure alone pushed contractors toward a narrow view. Mediators tend to subscribe to one of the two models of mediation I have set out above. Where a mediator subscribes to the narrow model, additional money probably will not substantially influence her or his approach to the mediation, which will continue to value speed of processing. On the other hand, a mediator who is inclined toward an open, facilitative approach, but who is given inadequate funding, may be driven by cost factors to do less preparation and digging for underlying interests in the mediation.

It also is possible, however, that cost factors may have inclined FmHA state offices to select contractors who had a narrow conception of mediation. It is doubtful that FmHA officials selected contractors based on the contractor's approach to mediation. It seems unlikely--at least in the early days of the program--that the persons involved would have recognized such differences. However, it is possible that persons holding narrow views of mediation could more easily submit lower cost proposals.

### 3. Addressing the Dichotomy

How should the Department of Agriculture and FmHA react to the problems created by the existence of these two alternative views of farmer-lender mediation?

First, it seems plain that Department of Agriculture sponsored research on the outcomes of the two approaches could foster understanding and improvement. I believe that the broad approach is generally preferable--that it is more congenial and usually produces superior outcomes.[323] But I have no empirical data to back up that conclusion, either from this program or another, and so I am relying on my own experience and discussions with others, both of which are filtered through my own values.

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[321] Interview with Carolyn Crowe, Director, United States Arbitration and Mediation Midwest, Inc. (May 9, 1990).

[322] Id.

[323] See Riskin, Mediation and Lawyers, 43 Ohio St. L. J. 29 (1982); Riskin, The Represented Client in the Settlement Conference: The Lessons of G. Heileman Brewing Co. v. Joseph Oat Corp., 70 Wash. U. L. Q. ___ (Jan. 1992).

Choosing one of these approaches may boil down to a choice of values. However, the choice could be aided by research into such issues as the extent to which mediators put these philosophical approaches into practice and the extent to which these approaches--as practiced--produce different outcomes. The results of such studies would help officials improve the farmer-lender mediation program and other government efforts in dispute resolution.

Second, the FmHA cannot wait for the results of such research. It should move quickly to foster a broad approach to mediation in the certified states. In the noncertified states, it should either foster a broad approach to mediation or articulate the differences between broad and narrow mediations for FmHA officials and for contractors.

### a. In Certified States

In states that have certified programs, the FmHA should do what is necessary to ensure that its representatives are willing and able to participate in broad mediations. When Congress enacted Title V of the Agricultural Credit Act of 1987, mandating "good faith" participation by agencies of the Department of Agriculture, the only existing state mediation programs were based on the broad approach; thus, to the extent that a Congressional intent on this point could be inferred, that intent must have been to require the department to participate in a broad type of mediation.[324]

### b. In Noncertified States

I believe that the FmHA also should promote broad mediation in noncertified states, though the case for this proposition is less clear. In addition to the likelihood of better outcomes, one reason for doing so is to provide services in the noncertified states that approximate those provided in certified state programs.[325] To achieve such parity, the FmHA would have to take steps to ensure that contractors understand and are capable of delivering broad services. In addition, to compensate contractors reasonably for their services might require significantly more than is currently paid by the FmHA in some states.

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[324] Note, however, that although certified mediation programs tend to follow a broad approach, the standards for certification set out in the statute are general and would allow for either approach to mediation. Agricultural Credit Act of 1987, §501, 7 U.S.C. §5101 (1988).

[325] Note 309 and accompanying text, supra.

I must also note, however, that the FmHA could choose not to pursue the goal of providing equivalent services. As mentioned above, the FmHA is not required by law to participate in or offer mediation services in states that do not have certified programs. Second, providing equivalent services in noncertified states might work against another important DOA objective--encouraging such states to develop mediation programs that will qualify for matching funds. Thus, it may be advisable for the FmHA to consider other options. One is the possibility of simply ensuring that the personnel in the FmHA state offices are sufficiently familiar with the differences between and advantages and disadvantages of the two approaches so that they can make an intelligent choice about the type of mediation services they wish to procure, and announce that to potential contractors.

### c. Moving Toward Broad Mediation

Moving uniformly toward broad mediation will not be simple. Each model of mediation has its own values and internal logic.[326] Yet in practice, it may sometimes be difficult to distinguish one approach from the other. Good mediators are sensitive to the participants' needs. Accordingly, sometimes a mediator who starts with a narrow approach may broaden it, and one who starts with a broad approach will narrow it in response to developments in the mediation.

In my experience, however, persons who are drawn to one model often have trouble recognizing the strengths of, or the need for, the other; what one sees depends upon what one is looking for.[327] In addition, the narrow model of mediation has the virtue of simplicity, whereas the broad model may call upon FmHA personnel to exercise judgment and develop new and innovative solutions. Some government officials could feel that this sort of endeavor--requiring the exercise of greater discretion--could create dangers to their careers. Moreover, the FmHA's farm lending programs are very large and involve hundreds of people in their administration. Therefore, the need for efficiency, fairness, uniformity, and order makes understandable the allure of a narrow approach to mediation, sometimes with exclusive reliance on the DALR$ program. For all these reasons, there may be a great deal of internal resistance to change in the direction I am proposing.

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[326] Secs. III.D.1.a. and b., III.D.2.c., supra.

[327] For a discussion of this problem centering on lawyers, which I think has validity in other situations as well, see Riskin, Mediation and Lawyers, 43 Ohio St. L. J. 29, 43-48, 57-59 (1982).

FmHA could consider a number of activities, however, that would enhance the likelihood of success in moving toward a broad mediation approach, such as:

-Modifying the rules of loan restructuring so that mediation takes place earlier, or otherwise giving more discretion to FmHA representatives than some currently believe they have. This could include taking appropriate measures to reduce the tendency of the DALR$ program to limit the purposes of mediation, such as encouraging the FmHA county offices to initiate mediation proceedings at an earlier stage in the processing of delinquent loans.

-Providing additional training to FmHA personnel who will be connected with mediation and to those who will be supervising mediations. Such training sessions should emphasize broad approaches to mediation and stress problem-solving negotiation.

-Developing demonstration videotapes that can be used both in training for FmHA personnel and for mediators in both state certified and FmHA contract mediation programs. Such videotapes could promote mutual understanding of the goals and possibilities in farmer-lender mediation.

# IV. Recommendations

## A. The FmHA should:

1. Take steps to remedy problems associated with the tension between the broad and narrow approaches to mediation by fostering a broad model of mediation in both certified state mediation programs and FmHA contract mediation programs. In order to achieve that goal, the FmHA should consider:

    a. Modifying FmHA rules for processing delinquent loans to the extent necessary to give FmHA representatives at farm-credit mediations greater discretion with respect to loan restructuring and providing new loans. This might include taking appropriate measures to reduce the tendency of the DALR$ program to limit the purposes of mediation, such as encouraging the FmHA county offices to initiate mediation proceedings at an earlier stage in the processing of delinquent loans;

    b. Providing additional training to FmHA personnel who will be connected with mediation and to their supervisors. Such training sessions should emphasize broad approaches to mediation and stress problem-solving negotiation skills; and

c. Developing training videotapes on farm-credit mediation that can be used to train FmHA personnel and mediators in both state certified and FmHA contract mediation programs.

2. Improve the system by which mediations are reported to it by certified state mediation programs and by FmHA state offices.

3. Take appropriate measures to notify parties to guaranteed loans of the availability of farmer-lender mediation.

## B. The Department of Agriculture should:

1. Continue to encourage additional states to develop farmer-lender mediation programs that can qualify to receive matching funds.

2. Encourage full participation in farmer-lender mediation by institutions of the Farm Credit System and all appropriate agencies of the Department;

3. Systematically encourage participation in farmer-lender mediation by other federal agencies that are connected with farm-credit disputes, such as the Federal Deposit Insurance Corporation, the Internal Revenue Service, the Resolution Trust Corporation, and the Small Business Administration.

4. Support research dealing with the conduct and outcomes of farmer-lender mediations using the broad and narrow approaches. The research should examine such questions as: To what extent do mediators follow their theoretical models in practice? To what extent do the two approaches, as practiced, result in different kinds of outcomes, levels of participation, or levels of satisfaction?

5. Consider the results of such research in contracting for and participating in farmer-creditor mediation.[328]

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[328] The results of such research also would be valuable to other federal agencies and courts in developing alternative dispute resolution efforts and to providers and consumers of mediation services across the United States.

**C. Other federal agencies that participate in alternative methods of dispute resolution should ensure that personnel involved in government disputes and those involved in procurement of dispute resolution services understand the differences between various approaches to mediation and negotiation and the advantages and disadvantages of each.**[329]

**Such knowledge will help these individuals select the most appropriate methods of dispute resolution and the most appropriate way to proceed in a given method of dispute resolution.**

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[329] As indicated in note 250, supra, commentators have found different systems of categorization useful for understanding mediation in different settings. While the "broad" and "narrow" dichotomy helps us understand farmer-lender mediation, another breakdown may be more useful in other arenas.

## Exhibit A

## *USDA Certified State Agricultural Loan Mediation Programs*

| 10/1/89 to 9/30/90 | KS | UA | MN | MT | ND | NE | SD | WI |
|---|---|---|---|---|---|---|---|---|
| 1. Open Cases Carried Forward | 176 | 247 | 374 | 2 | 63 | 28 | 87 | 46 |
| 2. Notices/Requests Received From: | 208 | 1236 | 620 | 275 | 1100 | 81 | 204 | 92 |
| 3. Total Cases | 384 | 1483 | 994 | 277 | 1163 | 109 | 291 | 138 |
| 4. Closed Cases | 298 | 1345 | 701 | 174 | 1104 | 96 | 270 | 46 |
| 5. Open Cases Remaining | 86 | 138 | 293 | 103 | 59 | 13 | 21 | 92 |
| 6. Disposition of "Closed" Cases: | | | | | | | | |
| 7. a) cases closed w/o mediation | 214 | 847 | 971 | 134 | 657 | 29 | 126 | 7 |
| 8. b) cases closed prior to mediation meeting | 127 | 847 | 73 | 30 | 133 | 14 | — | 15 |
| 9. 1) agreement reached | 76 | 396 | --- | 28 | 126 | 14 | --- | 8 |
| 10. 2) no agreement reached | 51 | 451 | — | 2 | 7 | — | --- | 7 |
| 11. c) Cases closed following mediation meeting | 84 | 498 | 604 | 14 | 314 | 53 | 144 | 24 |
| 12. 1) agreement reached | 79 | 411 | 376 | 13 | 214 | 44 | 97 | 19 |
| 13. 2) no agreement reached | 5 | 87 | 228 | 1 | 100 | 9 | 47 | 5 |
| 14. AGREEMENT RATE | 73% | 60% | 55.5% | 93% | 76% | 87% | 67% | 69% |

| OPEN CASES REMAINING 9/30/90 | KS | IA | MN | MT | ND | NE | SD | WI |
|---|---|---|---|---|---|---|---|---|
| Notices/Requests Received From: | | | | | | | | |
| FmHA | 6 | 34 | 79 | 20 | 21 | 2 | 14 | 0 |
| FCS | 3 | 51 | 47 | 0 | 32 | 0 | 5 | 0 |
| Other Creditor | 0 | 53 | 167 | 0 | 6 | 0 | 2 | 0 |
| Debtor | 77 | 0 | 0 | 3 | 0 | 11 | 0 | 92 |
| TOTAL | 86 | 138 | 293 | 23 | 59 | 13 | 21 | 92 |

(Distributed by Chester Bailey at CAMP meeting, April 11, 1991, St. Paul, MN)

### Report for Recommendation 91-8

# Adjudication of Civil Penalties Under the Federal Aviation Act

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This report was prepared for the consideration of the Administrative Conference of the United States. The views expressed are those of the author and do not necessarily reflect those of the members of the Conference or its committees except where formal recommendations of the Conference are cited.

# Executive Summary

The Federal Aviation Administration (FAA) is operating a demonstration civil penalty program under which the FAA can impose monetary penalties of up to $50,000 for violations of the Federal Aviation Act or its regulations. Under the demonstration program, the FAA prosecutes violations proposing initial civil penalties according to the discretion of the prosecuting FAA official. The persons on whom the penalties would be imposed, usually pilots, airlines, or airport operators, are entitled to an administrative hearing before an administrative law judge (ALJ), followed by the right to an administrative appeal before the administrator of the FAA. Violations of the Federal Aviation Act or the regulations resulting in suspensions or revocations of certificates of pilots, mechanics, or airlines follow a different administrative path. While those "certificate actions" begin with a prosecutorial decision made by an FAA official, the right to a hearing takes the case to the National Transportation Safety Board (NTSB), a separate agency. If the hearing is requested, an NTSB ALJ holds the hearing, and a right to appeal exists before the Board.

Before the demonstration civil penalty program was enacted, the FAA could propose penalties; but such penalties could be imposed only through a civil action brought in a United States District Court.

In 1990 the Administrative Conference of the United States, in Recommendation 90-1, recommended that the civil penalty program be continued, and that the responsibility for adjudication be studied further. In response to the Conference's Recommendation 90-1, the Congress extended the program for an additional 2 years. In that legislation, Pub. L. No. 101-370, Congress expressly asked the Conference to study the issue of "whether the authority to adjudicate administrative complaints under the Federal Aviation Act of 1958 should remain with the Department of Transportation (DOT), should be transferred to the NTSB, or should be otherwise modified." The additional Conference recommendation is due in mid-February 1992.

The Conference held a public hearing on Wednesday, June 19, 1991, to provide interested parties with the opportunity to present their views on these issues.[1]

After release of the draft of this report, the author convened an informal meeting with affected parties to explore the feasibility of a solution to the controversy that accommodates the reasonable needs of all of the affected

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[1] 56 Fed.Reg. 22693 (May 16, 1991) (notice of Conference Committee on Adjudication public hearing).

interests. No overall resolution was agreed to, but all parties expressed a willingness to seek common ground and to explore possible consensual resolution of the controversies over civil penalty adjudication.

There is no evidence of unfairness or mishandling of cases under the present system resulting from commingling of prosecutorial and judging functions. There are, however, strong feelings on the part of representatives of persons potentially subject to civil penalties about the possibility of unfairness. These perceptions should be taken into account in formulating the final form of the civil penalty program.

The FAA administrator, as the delegate of the Secretary of Transportation, is the public official charged with responsibility for making the national aviation system safe. Realization of the goal of aviation safety necessitates giving responsibility and authority to the official to be held accountable. Aviation safety requires tradeoffs among the content of regulations, operational arrangements for the air traffic control system, and enforcement policy. It is useful for the administrator of the FAA to be exposed personally to enforcement cases. Depriving the FAA administrator of enforcement responsibility artificially separates part of an overall matrix and impairs achievement of the safety goal.

It must be recognized that respondents in enforcement proceedings have an economic interest in the establishment or maintenance of the most cumbersome procedural requirements possible. While most of the affected interest representatives recognize the importance of aviation safety objects and accept the need for an efficient system for adjudicating allegations of violations of federal aviation regulations, some arguments against certain civil penalty adjudication configurations are motivated at least in part by a desire to return to a system in which administrative agencies lack civil penalty authority simply because that would mean fewer civil penalties are imposed. Thus, calls for the ultimate in procedural formality must be tempered with recognition of safety needs and efficiency goals.

The Congress already has decided to divide responsibility for aviation safety between the FAA and the NTSB, and the division of responsibility has worked reasonably well. This division of responsibility can support assigning civil penalty adjudication responsibility to either agency.

The existing FAA procedural rules separate prosecuting and judging functions as required by the APA. The existing arrangement potentially encourages forum shopping, although empirical evidence of such forum shopping is lacking.

Joint problem solving, involving the pilot community and the FAA in a spirit of reasonable harmony and trust is desirable. On the other hand, fairness and promotion of safety should not depend on the attitudes of individual incumbents of key positions in either the FAA or the NTSB.

It is useful for the administrator of the FAA and for the NTSB to be exposed personally to enforcement cases.

Use of alternative dispute resolution techniques, including mediation, arbitration, and settlement judges is desirable.[2]

It may be desirable to let the adjudicatory factfinder decide the penalty within valid penalty schedules and guidelines, so for example, an airline pilot could get a large fine instead of a 60-day suspension, which costs her her job.

Parties to enforcement proceedings should have an opportunity to challenge outcome determinative rules, policies, or standards applied in the adjudication, but the ALJ need not be the person who decides such challenges, and the FAA is not obligated to make all rules through notice-and-comment rulemaking.

The FAA should have the right to appeal from an NTSB decision, if the NTSB has decision-making authority.

The report recommends that the two agencies and the affected interests work out an institutional structure that meets their legitimate needs. In the absence of such a consensual resolution, it recommends that responsibility for adjudicating civil penalties and certificate actions against pilots be consolidated at the National Transportation Safety Board. It recommends that responsibility for adjudicating all other civil penalties and certificate action cases be consolidated at the FAA.

The report also recommends changes in procedures for discovery and for determining challenges to rules applied in adjudications, recommends enhancements in opportunities for voluntary resolution of individual cases, and greater use of electronic information technologies in both rulemaking and in handling individual cases.

# I. Introduction

The Federal Aviation Administration is operating a demonstration civil penalty program under which the FAA can impose monetary penalties of up to $50,000 for violations of the Federal Aviation Act or its regulations. Under the demonstration program, the FAA prosecutes violations proposing initial civil penalties according to the discretion of the prosecuting FAA official. The persons on whom the penalties would be imposed, usually pilots, airlines, or airport operators, are entitled to an administrative hearing before an administrative law judge, followed by the right to an administrative appeal before the administrator of the FAA. Violations of the Federal Aviation Act or the regulations resulting in suspensions or revocations of certificates of pilots, mechanics, or airlines follow a different administrative path. While those "certificate actions" begin with a prosecutorial decision made by an FAA official, the right to a hearing takes the case to the National Transportation Safety Board, a separate agency. If the hearing is requested, an NTSB ALJ holds the hearing, and a right to appeal exists before the board.

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[2] See Conference Recommendation 86-3, codified at 1 CFR §305.86-3 (use of alternative dispute resolution in individual case handling); Conference Recommendation 88-5, codified at 1 CFR §305.88-5 (use of settlement judges).

Before the demonstration civil penalty program was enacted, the FAA could propose civil penalties, but such penalties could be imposed only through a civil action brought in a United States District Court.

While the idea of administratively imposed civil penalties has been accepted reasonably well, the procedures under which civil penalties would be adjudicated, and the responsibility for formal hearings and administrative appeals have been controversial.

In 1990, the Administrative Conference of the United States, in Recommendation 90-1, recommended that the civil penalty program be continued, and that the responsibility for adjudication be studied further.

The present controversy, addressed by this report, is really about (1) the authority to decide administrative appeals from initial ALJ decisions and (2) the authority to establish procedural regulations that govern both the initial hearings and the administrative appeals. Less controversial is the question of which agency houses the ALJs who preside over the hearings.

The strongest criticisms of the unitary enforcement model applied to the civil penalty program have been related to separation of prosecutorial and judging functions.

## A. Fallon Report and Conference Recommendation 90-1

In June 1990, the Conference adopted Recommendation 90-1[3] regarding "Civil Money Penalties for Federal Aviation Violations." The recommendation asked Congress to make permanent the FAA administrative civil penalty program for violations of aviation safety rules, but recommended some changes to the FAA's procedural rules.

The Conference has long advocated the administrative imposition of civil money penalties as an alternative to reliance on judicial enforcement.[4] The Conference believes that administratively-imposed sanctions are generally faster, less expensive, and more effective in enforcing regulatory schemes than is reliance on judicial enforcement.[5]

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[3] 55 Fed.Reg. 34209 (Aug. 22, 1990).

[4] *See* Recommendation 72-6, "Civil Money Penalties as a Sanction", 1 CFR §305.72-6; Recommendation 79-3, "Agency Assessment and Mitigation of Civil Money Penalties", 1 CFR §305.79-3.

Consistent with its long-standing position in favor of administrative civil penalties,[6] the Conference recommended that administrative assessment of civil money penalties be made a permanent feature of federal regulation of aviation safety, and that the current cap of $50,000 be eliminated. The Conference noted that many agencies exercise power to impose far heavier monetary penalties than those now authorized in the civil aviation area. The Conference suggested that expanding the scope of money penalties following appropriate administrative hearings would enhance efficient administration without risking loss of fairness.

The Conference also recommended procedural changes, as long as the adjudicatory authority is lodged in the DOT. The FAA had previously interpreted its statutory authority as contemplating a formal finding of a violation (order assessing civil penalty) as a prerequisite to compromising a disputed civil money penalty case. As a result, fewer cases settled than under former agency practice, and a substantial backlog developed. In the ongoing rulemaking proceeding, the FAA reconsidered its position and concluded that it could compromise cases without a finding of a violation. The Conference recommended that Congress explicitly give FAA the discretion to compromise disputed cases without a formal finding of a violation.

The Conference observed that rules of practice governing adjudication of civil money penalty cases should be fair, and that they should appear fair. It found previous FAA regulations adequate for the most part, but found that several provisions led to some misunderstanding and perceptions of unfairness. The Conference recommended that the rules of practice be revised to eliminate existing ambiguities, pursuant to the ongoing notice-and-comment rulemaking. The Conference also noted that the proposed rule at the time of its Recommendation 90-1 substantially incorporated its procedural recommendations.[7]

With respect to location of the civil penalty adjudication responsibility, the Conference said:

> The Conference takes no position at this time on whether the adjudication of civil penalty actions under this program

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[5] Conference Recommendation 86-4, "The Split-Enforcement Model for Agency Adjudication", 1 CFR §305.86-4; Conference Recommendation 90-1, finding that FAA civil penalty program demonstrates the same advantages manifest with other such programs.

[6] *See* Conference Recommendation 72-6, reproduced as an appendix to this report.

[7] At the time Conference Recommendation 90-1 was adopted, June 7, 1990, the comment period on the FAA rule revisions had closed, but a final rule had not been issued.

> should remain a function of the DOT, or whether it should be shifted to the NTSB. There are arguments on both sides.
>
> * * *
>
> The better choice between the two is not self-evident. Factors that could not be adequately studied in the available time include the relative capacities of DOT and the NTSB to adjudicate cases promptly and fairly, any effect that the location of adjudicative authority might have on aviation safety, and the two agencies' respective capabilities to procure necessary resources. If Congress extends the aviation civil penalty program either permanently or for a substantial period, it is the Conference's intention to study the issue of the more appropriate location for adjudicatory authority.[8]

Recommendation 90-1 was based in part on a report, "Imposing Civil Money [Penalties] for Violations of the Federal Aviation Regulations: Implementing a Fair and Effective System," authored by Richard Fallon, Professor of Law at Harvard Law School. The final Conference recommendations deviated in significant ways from the Fallon recommendations, however. Most important for purposes of this report, Professor Fallon recommended that, "Congress should vest adjudicatory responsibility for civil money penalty cases under the Federal Aviation Act and its implementing safety regulations in the National Transportation Safety Board."[9]

## B. Statutory Requirement

In response to the Conference's Recommendation 90-1, the Congress extended the program for an additional 2 years. In that legislation, Pub. L. No. No. 101-370, Congress expressly asked the Conference to study the issue of "whether the authority to adjudicate administrative complaints under the Federal Aviation Act of 1958 should remain with the Department of Transportation, should be transferred to the NTSB, or should be otherwise modified." (Editor's note: Conference Recommendation 91-8 responded to this request.)

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[8] 55 Fed.Reg. 34209 (preamble to Recommendation 90-1).

[9] R. Fallon, Imposing Civil Money for Violations of the Federal Aviation Regulations: Implementing a Fair and Effective System at 52 (appendix of recommendations) (March 1990).

## C. Scope of This Study

This report begins where Recommendation 90-1 and Professor Fallon's report ended. It puts the Conference in a position to respond to the mandate in Pub. L. No. No. 101-370, and to fulfill the commitment expressed in the preamble to Recommendation 90-1 to examine further the question of adjudicatory authority for civil penalties.

This report probes in considerable detail the competing arguments in favor of NTSB authority and FAA authority, placing them in a legal and policy context for administrative adjudication. In evaluating these arguments, it gives careful attention to material presented at a public hearing on June 19, 1991.

This study considers not only whether civil penalty adjudication responsibility should be removed from the FAA, but also where civil penalty and certificate suspension/revocation adjudication authority might best be consolidated. It considers a variety of institutional arrangements to avoid an all-or-nothing character to a debate over civil penalty adjudication.[10]

The Conference held a public hearing on Wednesday, June 19, 1991, from 9:15 a.m. to 1 p.m. in Washington, DC. The hearing was intended to "provide interested parties with the opportunity to present their views on the issues raised, which include whether the FAA and Department of Transportation or the NTSB are the better forum adjudicating air safety enforcement cases, and whether responsibility for both certification cases and civil penalty cases should be at the same agency."[11]

After the draft of this report was released, the author convened an informal meeting with affected parties to explore the feasibility of a solution to the controversy that accommodates the reasonable needs of all of the affected interests. Participants in that meeting agreed that informal consultation was desirable and the author met further with representatives of the affected interests to discuss alternatives. While no overall resolution was agreed to, the willingness to seek common ground was enhanced, in the spirit of the recommendations.

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[10] *See generally* supplementary statement by Daniel D. Campbell at 2 (noting change in focus of debate to consolidation of civil penalty and certificate authority); *Id.* at 20 (urging Conference consideration of wide variety of institutional arrangements rather than an all-or-nothing focus).

[11] 56 Fed.Reg. 22693 (May 16, 1991) (notice of Conference Committee on Adjudication public hearing).

### D. Acknowledgements

A number of people were helpful in developing the information in this report. The author expresses appreciation to David A. Berg, Senior Attorney of the Air Transport Association; Timothy D. Bradbrooke, Villanova Law School class of 1993; John H. Cassady, III, Deputy Chief Counsel of the FAA; Daniel D. Campbell, General Counsel of the National Transportation Safety Board; David J. Campbell, Villanova Law School Class of 1992; Thomas Devine, Airport Operators Council International; Mary E. Downs, Assistant General Counsel and Secretary of the Air Transport Association; Michael W. Jones, Member of the Pennsylvania Bar; Kevin A. Marks, Villanova Law School Class of 1993; Michael Pangia, Member of the D.C. Bar; Kenneth P. Quinn, Chief Counsel of the FAA; Harry Riggs, Member of the Kentucky Bar; Michael S. Sundermeyer, Williams and Connolly, John Yodice, Counsel to the Aircraft Owners and Pilots Association.

## II. Statutory and Regulatory Framework

Civil penalty cases are initiated by the Federal Aviation Administration (FAA), an agency within the Department of Transportation (DOT). The cases are heard by DOT administrative law judges (ALJs), with appeal to the FAA Administrator. Judicial review is available in the federal court of appeals.

FAA certificate actions, if appealed, are adjudicated by the National Transportation Safety Board (NTSB).

The NTSB is an independent agency that has as its primary responsibilities investigating accidents and issuing air safety recommendations, in addition to adjudicating certificate cases.

The actual language of the pertinent statutes is presented in Appendix A.

### A. Substantive Statutory Provisions

The FAA has substantive regulatory authority under the Federal Aviation Act. It promulgates regulations to promote aviation safety, conducts investigations to ensure compliance, and brings enforcement actions. It also has responsibility for issuing certificates for most aviation businesses and functions.[12]

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[12] See 49 U.S.C. App. §§1421 (general regulatory authority), 1422 (air crew obligations), 1423 (aircraft requirements), 1424 (air carrier safety requirements), 1432 (airport operations), 1371-1389 (air carrier economic requirements).

In addition, the Hazardous Materials Transportation Act of 1975 authorizes the Secretary of Transportation to designate materials whose transportation may pose safety hazards and to promulgate regulations for the safe transportation of such materials. The Act's chief enforcement provision authorizes the Secretary to impose civil penalties of up to $10,000 per violation for knowing violations of the Act or regulations, after notice and hearing. The statute identifies factors to be considered in determining the appropriate penalty, such as the nature and seriousness of the violation, prior offenses, and ability to pay. The Secretary has delegated this enforcement authority to the units within the Department of Transportation that regulate the various modes of transportation.

## B. Civil Penalties

In 1987, Congress enacted a 2-year Civil Penalty Demonstration Program at FAA. For the first time, the program authorized the FAA to impose civil monetary penalties administratively in amounts less than $50,000 for violations of aviation safety rules. Until then, civil monetary penalties could only be imposed through cases brought in the federal courts by the Department of Justice.[13] The demonstration program was originally due to expire December 31, 1989. It was extended for 4 months in anticipation of the completion of a study of the program undertaken by the Administrative Conference of the United States at the request of the Department of Transportation. Congress extended the program an additional 90 days, after receiving a draft of the Conference recommendation from the Conference's Committee on Adjudication.

The civil money penalty program supplements previously available sanctions, which include judicially-imposed civil money penalties and FAA administrative actions to suspend or revoke certificates.

The civil money penalty program has been in operation since September 1988, when the FAA promulgated its procedural regulations as final rules with opportunity for subsequent comment. The FAA procedural rules were invalidated in 1990 in *Air Transport Association v. Department of Transportation*, discussed in §II(C) of this report. Subsequently, the FAA revised its procedural rules after an opportunity for notice and comment.

The FAA's rulemaking occurred in two steps. In early March 1990, the FAA issued a notice of proposed rulemaking on a number of specific issues in the civil penalty procedural rules that had been particularly controversial.[14] In mid-April, the FAA issued a final rule in this rulemaking, with a delayed effective date. At the same time the FAA put out its entire set of procedural rules, incorporating these changes, for notice and comment.[15] Final rules were issued in July 1990.[16]

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[13] Civil penalties for violation of hazardous materials statutes and regulations were the only exceptions. Those could be assessed administratively.

Under the final rules, a civil penalty case begins with a complaint issued by an agency attorney, providing notice of the violation alleged and the proposed civil penalty.[17] After the complaint is answered[18] a hearing is held before an administrative law judge.[19] The administrative law judge has the usual powers to supervise the hearing, including the power to issue subpoenas, receive evidence, regulate the course of the hearing, hold settlement conferences, resolve motions, and after the hearing makes findings of fact and conclusions of law and issues an initial decision.[20] The rules expressly deny the ALJ the power to issue orders of contempt, to award costs, or to impose any sanction not specified in the rules. If any such sanction is imposed, an interlocutory appeal may be filed of right.[21] Discovery is fairly broad, including depositions on oral examination "of any person," written interrogatories directed to a party, requests for production of documents or tangible items "to any person," and requests for admission by a party. Leave of the ALJ is not required. A party may discover any matter that is not privileged and that is relevant to the subject matter of the proceeding, and may discover information inadmissible at the hearing if it is reasonably calculated to lead to the discovery of admissible evidence.[22] The ALJ may limit discovery that is unduly burdensome or within commercial privileges.[23] The ALJ may impose sanctions for failure to make discovery including striking the responsible parties' pleading, precluding prehearing or discovery motions by that party, or precluding admission of that portion of that parties' evidence.[24] Interlocutory appeals are permitted as of right over orders barring a person from proceedings, failure to dismiss upon request of the parties, or orders by an ALJ in excess of the limitations on ALJ powers.[25] Other interlocutory appeals may be taken only with approval of the ALJ, which shall be granted when a party shows "that delay of the appeal would be detrimental to the public interest or would result in undue prejudice to any party."[26]

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[14] 55 Fed.Reg. 7980 (March 6, 1990) (NPRM inviting public comment on policy issues and proposed changes to the rules of practice regarding civil penalty authority).

[15] 55 Fed.Reg. 15110, 15111, 15134, 15135 (April 20, 1990) (final rule adopting changes to the rules of practice, and seeking comment on consolidated body of rules).

[16] 55 Fed.Reg. 27548 (July 3, 1990) (final rule in accordance with a decision of the United States Court of Appeals) (to be codified at 14 CFR Part 13).

[17] 14 CFR §13.208(c).

[18] 14 CFR §13.209.

[19] 14 CFR §13.204.

[20] 14 CFR §13.205.

[21] 14 CFR §13.205(b).

[22] 14 CFR §13.220.

[23] 14 CFR §13.220(f) (power to limit discovery); id. (g) (confidential orders).

[24] 14 CFR §13.220(n).

Unless it is appealed, the ALJ's initial decision becomes the final order assessing civil penalties.[27] Any party may appeal the initial decision based, however, only on the following grounds: lack of a preponderance of reliable, probative, and substantial evidence to support each finding of fact, failure of each conclusion of law to be consistent with "applicable law, precedent, and public policy," or commission of prejudicial errors during the hearing."[28] The FAA appellate decisionmaker[29] may raise new issues, as the NTSB may do on appeal of a certificate sanction, but if new issues are raised on appeal, the parties are entitled to develop a record before the ALJ who makes an initial decision on the new issue.[30]

Criteria for the amount of civil penalties are set forth in FAA Order 2150.3A rather than in the regulations.[31] The administrative law judge has authority to modify the proposed civil penalty based on evidence submitted at the hearing. This is a power that many interested parties do not understand exists, based on earlier proposed rules that were modified by the FAA.[32]

A review of the digests of administrator decisions under the civil penalty program[33] reveals the following about patterns of FAA administrator exercise of appellate authority in civil penalty cases:

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[25] 14 CFR §13.219(c).

[26] 14 CFR §13.219(b).

[27] 14 CFR §13.232(d).

[28] 14 CFR §13.233(b).

[29] The decisionmaker is the FAA administrator "acting in the capacity of the decisionmaker on appeal", or any person to whom the administrator has delegated that decision-making authority. 14 CFR §13.202.

[30] 14 CFR §13.233(j); 55 Fed. Reg. 27548, 27568 (July 3, 1990) (preamble to final regulations discussing new issues on appeal).

[31] 55 Fed. Reg. at 27569 (July 3, 1990) (preamble to final regulations, discussing sanction criteria).

[32] 14 CFR §13.232(a) ("in each...decision, the administrative law judge shall include finding of fact and conclusions of law upon...the amount of any civil penalty found appropriate by the administrative law judge...."); 55 Fed. Reg. at 27568 (July 3, 1990) (discussing power to modify civil penalty).

[33] *See* 56 Fed. Reg. 20250 (May 2, 1991); 56 Fed. Reg. 4886 (Feb. 6, 1991); 55 Fed. Reg. 45984 (Oct. 31, 1990).

> (1) Relatively few appeals involve pilots
>
> (2) Many appeals are withdrawn or abandoned
>
> (3) Relatively few appeals by persons against whom penalties have been imposed succeed
>
> (4) ALJs exercising discretion with respect to the amount of penalties frequently are reversed.

The separation of prosecutorial and judging functions has been a matter of particular concern to critics of the civil penalty program. This is the separation of functions provision of the final FAA rule:

**§13.203 Separation of Functions[34]**

> (1) Civil penalty proceedings, including hearings, shall be prosecuted by an agency attorney.
>
> (2) An agency employee engaged in the performance of investigative or prosecutorial functions in a civil penalty action shall not, in that case or a factually-related case, participate or give advice in a decision by the administrative law judge or by the FAA decisionmaker on appeal, except as counsel or a witness in the public proceedings.
>
> (3) The Chief Counsel, the Assistant Chief Counsel for Litigation, or attorneys on the staff of the Assistant Chief Counsel for Litigation will advise the FAA decisionmaker regarding an initial decision or any appeal of that civil penalty action to the FAA decisionmaker.

The acting chief administrative law judge of the Department of Transportation told the Conference committee at its June 19, 1991 hearing that FAA ALJs scrupulously enforce FAA separation of functions requirements.[35]

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[34] 55 Fed.Reg. 27548 (July 3, 1990) (to be codified at 14 CFR §13.203).

[35] Yoder statement at 4, (citing NL Industries, FAA Docket 84-29 (H.M.) initial decision, dated March 25, 1987, Appendix A, Order dated February 13, 1986); Western Airlines, Docket 85-108 (H.M.) Orders dated November 3 and 20, December 7 and 18, 1987, reversed in part, decision of the administrator on appeal, December 8, 1988; Omega Silicone Co., FAA Docket 87-152 (H.M.) decision dated May 8, 1991, P. 10, N. 9; American Airlines, FAA Docket CP89EA0019, Orders dated December 12, 1990, and May 31, 1991; Discovery Airways, OST Docket 46760, Orders dated May 16 and 25, 1990; Astro Containers, RSPA file 87-06-DM,

## C. *ATA v. Secretary of Transportation* Litigation

In *Department of Transportation. v. Air Transport Ass'n*,[36] the United States Court of Appeals for the District of Columbia Circuit held, inter alia, that the promulgation of the civil penalty rules[37] by the Federal Aviation Administration (FAA) violated the notice-and-comment requirements[38] of the Administrative Procedure Act[39] and that the FAA could not initiate new prosecutions under the rules unless and until they were properly repromulgated.[40] The United States Supreme Court granted a petition for certiorari[41] and vacated the court of appeals decision as moot and remanded[42] the case to the District of Columbia Circuit Court of Appeals, which vacated the case on mootness grounds, because revised FAA regulations had been issued after notice-and-comment.[43]

The *ATA* case concerned the necessity of engaging in notice-and-comment procedures preceding the FAA's promulgation of regulations controlling the adjudication of administrative civil penalty actions.[44] The FAA sought to characterize the civil penalty rules as falling within exceptions to the Administrative Procedure Act's notice-and-comment requirements.[45] The court of appeals found that the civil penalty rules could not properly be characterized as "rules of agency organization, procedure, or practice" because of the

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Administrative Law Judge decision, dated December 23, 1988, modified, decision of the administrator, dated December 19, 1989).

[36] 900 F.2d 369 (D.C. Cir. 1990), *vacated as moot and remanded*, __ U.S. __, 111 S.Ct. 944 (1991), *vacated as moot*, 933 F.2d 1043 (D.C. Cir. 1991).

[37] *See* 53 Fed. Reg. 34,646 (1988) (codified at 14 CFR pt. 13). The Penalty Rules established a schedule of civil penalties for violations of the Federal Aviation Act and Federal Aviation Regulations and "a comprehensive adjudicatory scheme providing for formal notice, settlement procedures, discovery, an adversary hearing before an ALJ and an administrative appeal." 900 F.2d at 373.

[38] *See* 5 U.S.C. §553 (1988) (requiring publication of general notice of proposed rulemaking in Federal Register after which interested parties shall have opportunity to participate in rulemaking process through comments).

[39] 900 F.2d at 375. In reaching its decision, the court of appeals first found that the procedural challenge to the promulgated rules was ripe for adjudication. *Id.* at 374-75. Because the court of appeals found the procedural challenge sufficient, the court did not address the substantive challenge to the penalty rules. *Id.*

[40] *Id.* at 380.

[41] __ U.S. __, 111 S.Ct. 669 (1991).

[42] __ U.S. __, 111 S.Ct. 944 (1991).

[43] 933 F.2d 1043 (D.C. Cir. 1991).

[44] 900 F.2d at 371.

[45] *Id.* at 371-72.

substantial impact of those rules on a civil penalty defendant's substantive right to an administrative adjudication.[46] Nor could statutory time limits provide "good cause" for eschewing notice-and-comment procedures.[47] Also, the FAA's response to postpromulgation comments could not cure noncompliance with section 553's notice-and-comment requirements.[48]

## D. Certificate Actions

Section 609 of the Federal Aviation Act[49] authorizes the Secretary of Transportation (who delegated the authority to the Administrator of the FAA)[50] to amend, modify, suspend, or revoke type certificates, production certificates, airworthiness certificates, airman certificates, air carrier operating certificates, air navigation facility certificates (including airport operating certificates), and air agency certificates. The FAA must, unless it finds that an emergency exists, provide a hearing. A person adversely affected by the FAA decision may appeal the order to the National Transportation Safety Board (NTSB), which may "after notice and hearing, amend, modify, or reverse the [FAA ] order if it finds that safety in air commerce or air transportation and the public interest do not require affirmation of the [FAA] order." The NTSB is not bound by FAA findings of fact. An NTSB appeal stays the effect of an FAA order, unless the FAA declares that an emergency exists and that safety requires the immediate effectiveness of the order. In such emergency cases, the NTSB must decide the appeal within 60 days.

The NTSB publishes digests of its appellate decisions, but not in WESTLAW, LEXIS or the Federal Register.

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[46] *Id.* at 376. Section 553(b)(A) of the Administrative Procedure Act provides that notice prior to promulgation of regulations is not required for "interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice . . ." 5 U.S.C. §553(b)(A).

[47] *Id.* at 378-79. The FAA argued unsuccessfully that the two year duration of section 1475's demonstration program brought the Penalty Rules within the "good cause" exception to notice-and-comment requirements. *Id.* Section 553(b)(B) of the Administrative Procedure Act provides a second exception from notice requirements "when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest." 5 U.S.C. §553(b)(B).

[48] *Id.* at 379.

[49] 49 App. U.S.C. §1429.

[50] 14 CFR §1.47 (1991).

## E. History of NTSB Authority to Adjudicate Certificate Actions

Regulation of civil aviation by the federal government originated with the Air Commerce Act of 1926,[51] which created an Aeronautics Branch under the authority of the Department of Commerce.[52] The current National Transportation Safety Board evolved nearly 30 years later from the first accident investigation panel created by regulations promulgated by the Secretary of Air Commerce in 1937.[53]

The following year Congress passed the Civil Aeronautics Act of 1938.[54] That act consolidated government regulation of aviation within a newly created Civil Aeronautics Authority that included an independent Air Safety Board charged with investigating accidents and recommending accident prevention measures.[55] In 1940 the Civil Aeronautics Authority was reorganized into two separate agencies, the Civil Aeronautics Administration and the Civil Aeronautics Board (CAB).[56] The Bureau of Safety under the CAB assumed all authority for investigation of civil aviation accidents upon the abolition of the Air Safety Board.[57]

In 1958, Congress passed the Federal Aviation Act[58] that created the Federal Aviation Administration and transferred some of the CAB's responsibilities, including rulemaking and general enforcement duties, to the FAA.[59] Adjudicatory and accident investigatory functions, however, continued to be exercised exclusively by the CAB.[60]

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[51] Pub. L. No. No. 69-254, 44 Stat. 568 (1926) (repealed in part, 1938; in full, 1958).

[52] Atwood, *Admissibility of National Transportation Safety Board Reports in Civil Air Crash Litigation*, 53 J. Air L. & Com. 469, 470 (1987); Comment, *Judicial Review for the FAA: An Additional Safeguard for Aviation Safety*, 29 Am. U. L. Rev. 713, 723 (1980).

[53] Atwood, at 471.

[54] Pub. L. No. No. 75-706, 52 Stat. 973 (1938) (repealed 1958).

[55] Note, *Aviation: The Rule for Admissibility: Building a Balance Between the Interests of Air Safety and the Interests of Aviation Litigation*, 41 Okla. L. Rev. 265, 268 (1988); Atwood, at 471-72.

[56] 41 Okla L.Rev. at 268.

[57] *Id.*

[58] Pub. L. No. No. 85-726, 72 Stat. 731 (current version at 49 U.S.C. §§1301-1542 (1988)).

[59] Atwood, at 472; Note, at 269; Comment, at 724.

[60] Comment, at 724. All functions, powers, and duties of the Civil Aeronautics Board were terminated or transferred by Pub. L. No. No. 95-504, s 40(a), Oct. 24, 1978, 92 Stat. 1744, effective on or before Jan. 1, 1985.

The legislative history of the 1958 Act[61] shows that the primary Congressional focus was on creating the appropriate institutional framework for safety rulemaking authority, exercised in the context of responsibility of a well-planned aviation system. "An understanding of the system sought to be achieved and a knowledge of the problems faced at the operations level are necessary if the regulations are to accomplish their purpose. Once promulgated, the regulations must be applied and enforced, and, if need be, modified or repealed to meet changing conditions."[62] The arrangement left the Civil Aeronautics Board, "an independent quasi-judicial body," to hear certificate action appeals. In order to "expedite the safety-enforcement process," the Act permitted the FAA to take certificate action before formal proceedings before the CAB were permitted, but preserved the right to "a full hearing complying in all respects with the requirements of the Administrative Procedure Act," before the Board.[63] In all, the House Report discussed the adjudicatory responsibility in three relatively brief paragraphs. The language used, the institutional starting point and the brevity of the analysis all suggest that the Congress gave relatively little attention to the unitary enforcement model, but created a split enforcement model to centralize policy and rulemaking responsibility. The CAB opposed transfer of rulemaking authority to the new FAA, although it did favor a single aviation agency "responsible for the research, development, installation, maintenance, and operation of aviation facilities and services relating to air traffic control."[64] It argued that the quasi-legislative rulemaking function should be retained by an independent agency more subject to congressional control.

Eight years later, Congress created the National Transportation Safety Board with the passage of the Department of Transportation Act of 1966.[65] The NTSB consists of five members appointed by the President, with the advice and consent of the Senate, of which at least three members "have been appointed on the basis of technical qualification, professional standing, and demonstrated knowledge in the fields of accident reconstruction, safety engineering, human factors, transportation safety, or transportation regulation."[66] The original scheme, which placed the NTSB within the Department of Transportation (DOT), gave the NTSB responsibility for investigating all transportation accidents and jurisdiction over all challenges involving certificates or licenses issued by the Secretary of Transportation or the Administrator of the FAA.[67]

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[61] House Report No. 2360, 95th Cong. 2d Sess., reprinted in 1958 U.S. Code Cong. & Admin. News 3741.

[62] 1958 U.S. Code Cong. & Admin. News at 3747.

[63] 1958 U.S. Code Cong. & Admin. News at 3748.

[64] Letter from Chairman of Civil Aeronautics Board to Chairman of House Commerce Committee, dated July 29, 1958, reprinted in 1958 U.S. Code Cong. & Admin. News at 3763.

[65] Pub. L. No. No. 89-670, 80 Stat. 935 (codified at 49 U.S.C. §§312, 1651-1659 (1988)).

[66] 49 U.S.C. §1902(b)(1) (1988).

The Independent Safety Board Act of 1974[68] removed the NTSB from the Department of Transportation to avoid undue deference to the interests of the DOT by the Board in the performance of its duties.[69] This Act increased the NTSB's investigative authority, set forth standards for responding to safety recommendations, and clarified the separation between the FAA and the NTSB.[70]

The NTSB as a matter of policy defers to FAA interpretations of the FAA rules and the Federal Aviation Act. It does not, however, defer with respect to the standard contained in its own statute for reviewing certificate actions: that the board shall approve an FAA certificate suspension or revocation unless it finds that safety in air commerce or air transportation and the public interest do not require affirmation of the order.

## III. Split Enforcement Model

The institutional arrangement for certificate actions under the Federal Aviation Act, and the arrangement preferred by some of the interest groups for civil penalties is known as the "split enforcement model." While this model is not unknown, it is relatively unusual. The most prominent examples of split enforcement outside the transportation context are OSHA/OSHRC and MSHA/MSHRC, dealing with employee health and safety, and OPM/MSPB, dealing with federal employee rights.

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[67] Comment, at 729. Although the Board was not specifically given any original investigative authority, in practice the NTSB began to initiate original investigations of accidents, partly due to the migration of many of the former Bureau of Aviation Safety staff into the new NTSB structure. Note, at 269.

[68] Pub. L. No. No. 93-633, title III, 88 Stat. 2166 (codified at 49 U.S.C. §§1901-1907 (1988)). For legislative history and purpose of Pub. L. No. No. 93-633 (Independent Safety Board Act), see 1974 U.S.Code Cong. and Admin.News, p. 7669.

[69] Comment, at 729-30. As of April 1, 1975, the NTSB has functioned as an independent agency. Atwood, at 485.

[70] Note, at 269-70.

## A. Occupational Safety and Health Review Commission

The Occupational Safety and Health Act[71] assigns responsibility to two distinct administrative agencies: the Occupational Safety and Health Administration (OSHA) within the Department of Labor, and an independent Occupational Safety and Health Review Commission (OSHRC). OSHA sets and enforces workplace health and safety standards, promulgating regulations[72] and investigating violations, issuing citations, and assessing monetary penalties against noncomplying employers.[73] OSHRC exercises adjudication responsibility.[74] Employers wishing to contest OSHA citations are entitled to hearings before OSHRC administrative law judges, reviewable by the commission itself in its discretion.[75] Judicial review is available to either party,[76] but reviewing courts of appeals must treat commission findings of fact as conclusive so long as they are supported by substantial evidence.[77]

The Supreme Court has referred to this as an "unusual regulatory structure."[78]

The Court noted that the Congress set up this structure to achieve greater separation of functions than exists within traditional unitary agencies under the APA.[79] Senator Javits justified the separation, acknowledging that it went beyond what was required by the APA.[80]

The OSHA split enforcement model has been troublesome. In addition to the deference issue discussed in §III(D) of this report, the Supreme Court was forced to referee another jurisdictional dispute between the Secretary and the Commission. *Cuyahoga Valley Railroad v. United Transportation Union*,[81] arose from the Commission taking the position that it could conduct administrative adjudication even when OSHA moved to vacate a citation. The

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[71] 29 U.S.C. §651-678 (1988).

[72] 29 U.S.C. §665 (1988).

[73] 29 U.S.C. §§658-659, 666 (1988).

[74] 29 U.S.C. §651(b)(3) (1988).

[75] 29 U.S.C. §659(c) (hearing and order); 29 U.S.C. §661(j) (1988) (discretionary review).

[76] 29 U.S.C. §660 (authorizing petitions for judicial review either by affected persons or by secretary) (1988). The Solicitor of Labor is expressly authorized to appear in civil litigation for the secretary, although under the direction and control of the Attorney General. 29 U.S.C. §663 (1988).

[77] 29 U.S.C. §660(a)-(b) (1988).

[78] Martin v. OSHRC, ___ U.S. ___, 111 S. Ct. 1171 (1991).

[79] ___ U.S. at ___.

[80] *Martin*, ___ U.S. at ___ (citing S. Rep. No. 91-1282 at 56, reprinted in Legislative History 195 (individual views of Senator Javits)).

[81] 474 U.S. 3 (1985).

Supreme Court held that the commission lacked that power because necessarily associated with OSHA's enforcement responsibility is the authority to withdraw citations and enter into settlement discussions with employers.[82]

## B. Mine Safety and Health Review Commission

The Mine Safety and Health Act[83] authorizes the Secretary of Labor to assess civil penalties up to $10,000 for each violation of mandatory mine health or safety standards or for other violations of the Act.[84] The Act also establishes the Federal Mine Safety and Health Review Commission[85] as an independent agency with five members appointed by the President by and with the advice and consent of the Senate. The Secretary (acting through the Mine Safety and Health Administration) starts the civil penalty process by issuing a notice of proposed civil penalty.[86] If a mine operator, a miner, or a miner representative wishes to contest the proposed penalty, that person is entitled to a hearing before an ALJ assigned to MSHRC.[87] The full commission, or a panel of three members, hears discretionary appeals from ALJ decisions, which become final within 40 days after their issuance otherwise.[88] Petitions for Commission review of ALJ decisions are limited to one of five statutory grounds.[89] Judicial review is available on petition by any person adversely affected or aggrieved by a commission order or by the Secretary of Labor.[90]

## C. Merit Systems Protection Board

The Civil Service Reform Act places administrative and operational responsibility for the federal civil service system in the Office of Personnel Management, and places adjudicatory responsibility in the separate Merit

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[82] *Martin*, ___ U.S. at ___ (citing and quoting *Cuyahoga Valley Railroad Company*,_474 U.S. at 6-7).

[83] 30 U.S.C. §§801-962 (1988).

[84] 30 U.S.C. §820 (1988).

[85] 30 U.S.C. §823 (1988).

[86] 30 U.S.C. §815(a)-(b). (1988).

[87] 30 U.S.C. §815(d). (1988).

[88] 30 U.S.C. §823(d). (1988).

[89] 30 U.S.C. §823(d)(2)(ii) (1988).

[90] 30 U.S.C. §816 (1988). The Solicitor of Labor may represent the secretary in civil litigation subject to the direction and control of the Attorney General. 30 U.S.C. §822 (1988).

Systems Protection Board.[91] Federal sector employees adversely affected by an agency decision may appeal to the MSPB, which can hear the appeal directly or through an administrative judge (not an ALJ).[92] Subsequent administrative appeal to the full Board is discretionary.[93] Judicial review is within the jurisdiction of the United States Court of Appeals for the Federal Circuit, exercisable on petition by the employee or by the director of the Office of Personnel Management.[94]

## D. To Whom Does a Reviewing Court Defer When Enforcement Authority is Split?

When enforcement responsibility is split between two agencies, courts reviewing administrative decisions sometimes must decide between the two agencies in deferring to administrative discretion.

The Supreme Court was presented with this problem in *Martin v. Occupational Safety and Health Review Commission*.[95] That case involved the allocation of responsibility between the OSHA and the OSHRC, described earlier in §III(A) of this report. OSHA cited a steel manufacturer for leaky respirators. The review commission vacated the citation, interpreting OSHA regulations in a way that did not support the violation asserted by OSHA. On review at the request of OSHA, the court of appeals determined that the regulations were ambiguous and that deference was due the Commission's interpretation. The Supreme Court reversed, inferring from the Occupational Safety and Health Act[96] congressional intent "to invest interpretive power in the administrative actor in the best position to develop [historical familiarity and policymaking expertise]."[97] It concluded that OSHA was more likely than the commission to develop these attributes because OSHA promulgates the standards, and thus is in a better position to reconstruct the purpose of the regulations. Also, "by virtue of the secretary's statutory role as enforcer, the secretary comes into contact with a much greater number of regulatory problems then does the commission, which encounters only those regulatory episodes resulting in contested citations."[98] The court noted that granting deference to the commission would reenforce the congressional determination to protect regulated parties from biased decision-making by OSHA, nevertheless concluding that such deference would frustrate congressional intent to make a single administrative actor accountable for overall implementation of the act.[99]

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[91] 5 U.S.C. §7701 (1988).

[92] 5 U.S.C. §7701(b) (1988).

[93] 5 U.S.C. §7701(e) (1988).

[94] 5 U.S.C. §7703 (1988).

[95] ___ U.S. ___, 111 S. Ct. 1171 (1991).

[96] 29 U.S.C. §§651-678 (1988).

[97] ___ U.S. at ___.

[98] ___ U.S. at ___.

The court emphasized that it took no position on the division of enforcement and interpretive powers within other regulatory schemes conforming to the split enforcement structure. It also emphasized that it was saying nothing about whether particular divisions of enforcement and adjudicative power within a unitary agency comport with section 554(d) of the APA.[100]

Recognizing that the Supreme Court in *Martin v OSHRC* expressed no views on the relationship between the FAA and the NTSB, it nevertheless is useful to apply the factors it used to decide the OSHA review commission case to the FAA/NTSB situation. Because the NTSB, unlike the review commission, investigates accidents, it has comparatively more familiarity with regulatory problems than the review commission did. Thus, the second factor of the Court's formula would permit deference to the NTSB. The first factor, however, presuming sounder interpretation from the agency promulgating regulations in the first place, militates as strongly in favor of deference to the FAA as it did in favor of deference to OSHA. The NTSB, like the review commission, has no responsibility for promulgating regulations. Accountability of a single public official, a third factor mentioned by the *Martin* court, albeit in another part of the opinion rejecting an argument by the respondent steel company, militates in favor of deference to the FAA administrator because that official, more than the NTSB, has overall responsibility for air safety.

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[99] Accord, Conference Recommendation 86-4, 1 CFR §305.86-4 (1991) (recommendation deference to program agency in split enforcement model).

[100] ___ U.S. at ___ (Part III). Section 554(d) of the APA is considered in §V(B) of this report.

# IV. Unitary Enforcement Model

## A. Most Agencies Follow Unitary Model of Enforcement

As the Supreme Court said within the last year, "under most regulatory schemes, rulemaking, enforcement, and adjudicative powers are combined in a single administrative agency."[101]

In this "unitary" agency model, enforcement and adjudication responsibilities must be divided between separate personnel under §554(d) of the APA, discussed in §V(B) of this report.[102]

The Environmental Protection Agency ("EPA"), in addition to the other agencies identified in the discussion of separation of functions, illustrates the unitary enforcement model applied to civil penalties under several different environmental statutes.[103] Under consolidated rules of practice for these civil penalty programs, the EPA commences a proceeding by issuing a complaint.[104] Certain motions made before a complaint is answered are decided by the regional administrator, and other motions are decided by the assigned ALJ.[105] Hearings are available as a matter of right when requested in the answer.[106] Prehearing conferences are held for the purpose of exploring settlement and simplification of issues.[107] Except for exchange of witness list and documents routinely accomplished at the prehearing conference,[108] discovery is permitted only when the ALJ determines that the discovery sought will not unreasonably delay the proceeding, that the information sought through discovery is not otherwise obtainable, and that the information sought has significant probative value. Depositions on oral questions are permitted only on a finding that the information sought cannot be obtained by alternative methods or that relevant and probative evidence may not otherwise be preserved for presentation by a witness at the hearing.[109] After the hearing, the ALJ issues an initial decision, which may include a penalty amount different from that recommended in the complaint, but if she does so, must provide specific reasons for any increase or decrease.[110] The initial decision becomes a final order of the administrator unless an appeal is taken to the administrator.[111] Interlocutory appeal ordinarily is available only on certification by the ALJ,[112] or "except when the administrator determines, upon motion of a party and an exceptional circumstances, that to delay review [until review of the initial decision] would be contrary to the public interest."[113] On appeal, the issues are limited to those raised by the parties during the course of the proceeding before the ALJ.[114]

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[101] *Martin*, ___ U.S. at ___ (citing 15 U.S.C. §41 (Federal Trade Commission); 15 U.S.C. §§77s-77u (Securities and Exchange Commission); 47 U.S.C. §151 (Federal Communications Commission)). But see Preamble to Conference Recommendation 86-4, codified at 1 CFR §305.86-4 (1991) (taking no position on whether split enforcement or unitary enforcement model is preferable).

[102] Martin v. OSHRC, ___ U.S. at ___ (citing 5 U.S.C. §554(d) and Johnson, *The Split Enforcement Model: Some Conclusions From the OSHA and MSHA Experiences*, 39 Admin. L. Rev. 315, 317-319 (1987).

[103] See generally 40 CFR Part 22 (1991); 40 CFR §22.01 (scope of procedural rules).

[104] 40 CFR §22.13 (1991).

[105] 40 U.S.C. §22.16 (1991).

[106] 40 CFR §22.15(c) (1991).

[107] 40 CFR §22.19 (1991).

[108] 40 CFR §22.19(b) (1991).

The administrator may delegate all or part of his authority to act in any given proceeding.[115] The person to whom powers are delegated may not be involved in the prosecutorial function.[116]

## B. Separation of Functions

Many nonaviation agencies have administrative civil penalty programs, and a number of them have specifically addressed the separation of function questions in their procedural regulations. Other agencies' procedures for assessing civil penalties generally provide for an assessment order, followed by a hearing on the record, resulting in an order, which sometimes is reviewable by the agency.[117]

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[109] 40 CFR §22.19(f) (1991).

[110] 40 CFR §22.27(b) (1991).

[111] 40 CFR §22.27(c) (1991).

[112] 40 CFR §22.29 (1991).

[113] 40 CFR §22.29(c) (1991).

[114] 40 CFR §22.30(c) (1991).

[115] 40 CFR §22.04(b)(3).

[116] 40 CFR §22.04(b)(2) (1991).

[117] *See, e.g.*, 10 CFR §2.205 (NRC); 12 CFR §19.81-.83 (Comptroller of the Currency); 12 CFR §263.22-.29 (Federal Reserve Board); 12 CFR §308.55-.76 (FDIC); 12 CFR §509.34-.38 (Office of Thrift Supervision); 12 CFR §622.52-.60 (Farm Credit Administration); 12 CFR §747.401-.409 (National Credit Union Administration); 15 CFR §904.1, .100-.108 (procedural regulations applicable to NOAA under marine sanctuary regulations) §§935.8 & 936.7 (private remote sensing space systems regulations) pt 960 (deep seabed mining) pt 971.

The Congress relatively recently has had occasion to consider a separation of functions in the unitary enforcement model on a government-wide basis. In 1986, it enacted the Program Fraud statute.[118] While the statute is unusual in the relationships it establishes between responsible agencies and the Justice Department, it does validate the unitary enforcement model with separation of functions protections equivalent to those provided by the FAA in its civil penalty demonstration program. The program fraud regulations of a number of agencies contain standard separation of functions language.[119]

The program fraud statute imposes civil penalties for false claims or statements.[120] It provides for investigations of potentially false claims or statements,[121] followed by presentation of investigative results to a reviewing official.[122] If the reviewing official determines, based on the investigative report, that there is adequate evidence to believe a violation has occurred, that official gives notice to the Attorney General of an intention to refer the allegations to the presiding official of the agency.[123] The presiding official may proceed with the case only if the Attorney General does not object.[124] Civil penalty proceedings before the presiding official begin with notice to the person accused,[125] and thereafter are conducted either under the APA, supplemented by agency procedural regulations meeting the requirements of 31 USC §3803(g)(3) or for agencies not subject to the APA procedures, under agency regulations meeting the requirements of 31 USC §3803(g)(2).

Section 3803(g)(2)(D) has specific separation of functions language, disqualifying the investigating and reviewing officials from participating or advising in the initial decision under §3803(h) or the review of that decision under §3803(i). This disqualification is stated in essentially the same language as the separations of functions language of 5 USC §554(d), except for reference to "related case":

> [procedural regulations shall] ensure that the investigating official and the reviewing official do not participate or advise

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[118] 31 U.S.C. §3801-3812, 100 Stat. 1874 (1986).

[119] *See, e.g.*, 20 CFR §355.14 (Railroad Retirement Board); 13 CFR §142.14 (Small Business Administration); 22 CFR §35.14 (Department of State); 22 CFR §224.14 (Agency for International Development).

[120] 31 U.S.C. §3802(a).

[121] 31 U.S.C. §3803(a)(1).

[122] 31 U.S.C. §3803(a)2).

[123] 31 U.S.C. §3803(a)(2).

[124] 31 U.S.C. §3803(b)(2).

[125] 31 U.S.C. §3803(d)(2).

> in the decision required under subsection (h) of this section or the review of the decision by the authority head . . . .[126]

In his prepared statement for the June 19, 1991 Conference hearing, the chief counsel of the FAA identified the United States Coast Guard,[127] the Office of the Comptroller of the Currency,[128] the Federal Reserve Board,[129] the Federal Deposit Insurance Corporation,[130] the Nuclear Regulatory Commission,[131] the Federal Energy Regulatory Commission,[132] and DOT Aviation Economic Matters[133] as examples of agencies with civil penalty authority in which the prosecutorial and adjudicatory functions are performed by separate organizational components within a chief legal officer's organizational entity.

The EPA procedural rules do not specifically address separation of advisory functions performed by counsel but do require that persons exercising authority delegated by the administrator not perform prosecutorial functions.[134]

# V. Legal Requirements for Separating Functions

Separation of functions in the agency context is conceptually related to separation of powers in the Constitutional context, although the requirements are quite different.

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[126] 31 U.S.C. §3803(g)(2)(D).

[127] Separation of functions procedure in 33 CFR §1.07 prohibits chief counsel attorneys giving prosecutorial advice from participating in adjudicatory proceeding.

[128] 12 CFR §19.15 (prosecutorial function exercised by enforcement and compliance division within chief counsel's office; appellate decisionmaker advice comes from legislative and regulatory analysis division within chief counsel's office).

[129] 12 CFR §263.15 (permitting only members of the board staff not engaged in investigative or prosecuting functions to advise and assist the board in considering a case).

[130] 12 CFR §308.44 (only FDIC staff not participating in investigative or prosecutorial functions may advise and assist the board in considering a particular case).

[131] 10 CFR §2.781 (attorneys from licensing and enforcement division within general counsel's office prosecute; attorneys from regulations and adjudication division within general counsel's office advise commissioners on adjudicatory matters).

[132] 8 CFR §385.2202 (no person involved in investigation or trial may participate or advise as to findings, conclusions, or decision except as a witness or counsel in public proceedings).

[133] 14 CFR §300.4 (attorneys reporting to assistant general counsel for aviation enforcement proceedings prosecute enforcement cases; attorneys reporting to assistant general counsel for environmental, civil rights, and general law advise appellate decisionmaker-usually the assistant secretary for Policy and International Affairs).

[134] 40 CFR §22.04(b)(2) (1991).

## A. Constitutional Requirements

The principle of separation of powers relates to the apportionment of different governmental functions to distinct and relatively independent governmental bodies.[135] This goal is achieved in the American system of government under the Constitution through separate branches of government consisting of the legislative[136] (making the laws), the executive[137] (effectuating the laws), and the judicial[138] (deciding what the laws mean) branches.[139] Due to the great power of the legislature, that branch is further subdivided bicamerally, to reflect both equality among the states and proportional representation of the people.[140]

In *Mistretta v. United States*,[141] the United States Supreme Court held that separation of powers principles under the Constitution were not violated by the Sentencing Reform Act of 1984, which established the United States

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[135] *See generally,* Sargentich, *The Contemporary Debate About Legislative-Executive Separation of Powers* 72 Cornell L. Rev. 430, 464-68 (1987) (exploring tension inherent in themes of separation and checks and balances); Strauss, *Formal and Functional Approaches to Separation-of-Powers Questions--A Foolish Inconsistency?*, 72 Cornell L. Rev. 488 (1987) (comparing and contrasting formal and functional approaches to separation of powers analysis reflecting, respectively, strict separation of functions and flexible interpretation permitting greater intermingling of powers); Osgood, *Governmental Functions and Constitutional Doctrine: the Historical Constitution*, 72 Cornell L. Rev. 553, (1987) (arguing that historical context plays important part in constitutional decision-making in addition to conventional doctrinal formulations of the law).

[136] The Constitution states that: "All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and a House of Representatives." U.S. Constitution, art. I., §1.

[137] The Constitution provides that; "The executive Power shall be vested in a President of the United States of America." U.S. Constitution, art. II., §1. Prosecutorial functions are executive functions.

[138] The Constitution requires that: "The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish." U.S. Constitution, art. III., §1.

[139] For a discussion of the historical background of separation of powers principles, see Parker, *The Historic Basis of Administrative Law: Separation of Powers and Judicial Supremacy*, 12 Rutgers L. Rev. 449, 451-64 (1958) (tracing historical development of separation of powers doctrine from Aristotle to Locke to Montesquieu); Sharp, *The Classical American Doctrine of "The Separation of Powers"*, 2 U. CHI. L. REV. 385 (1935) (discussing historical evolution of separation of powers concepts from antiquity through early American constitutional theorists such as Adams and Madison).

[140] U.S. Constitution, art. I., §1. *See* Sargentich, at 436 (bicameral structure of legislature serves as internal check against excessive legislative accretion of power).

[141] 488 U.S. 361 (1989).

Sentencing Commission composed of federal judges sharing rulemaking authority with nonjudges and subject to the President's power to appoint or remove for cause.[142] The Court found that the Constitutional mandate requiring the separation of governmental functions among the different branches does not prevent the exercise of some rulemaking authority by an independent agency within the Judicial Branch.[143]

In *Touby v. United States*,[144] the Supreme Court rejected a challenge to commingling rulemaking and prosecutorial functions in the Department of Justice. In doing so, the court flatly rejected separation of powers arguments. "The principle of separation of powers focuses on the distribution of powers *among* the three coequal branches; it does not speak to the manner in which authority is parcelled out within a single branch.[145] Thus, under *Touby* any constitutional constraints on commingling of functions within administrative agencies must be derived from the due process requirement rather than from the separation of powers requirements.

The constitutional cases say two things pertinent to the handling of aviation civil penalties: (1) commingling of functions is not unconstitutional; (2) bias on the part of an adjudicator violates due process regardless of whether it arises because of economic interest or otherwise. Conceptually, functions could be commingled so completely that the decision-making process would be biased in contravention of due process.

## 1. Due Process and Combination of Functions

Administrative agencies appear at times to exercise all three governmental powers (i.e., legislative, prosecutorial, and adjudicative functions),[146] but the courts and the Congress regularly have approved such commingling of functions. Indeed, the United States Court of Appeals for the Sixth Circuit in an unpublished opinion rejected the argument that the FAA's separation of functions procedures in civil penalty proceedings violates due process.[147]

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[142] *Id.* at 412.

[143] *Id.* at 386-87. More generally, the Court has stated that separation of powers doctrine pertains to the distribution of powers *among* the Branches, not *within* a particular Branch. Touby v. United States, 59 U.S.L.W. 4447, 4449 (U.S.. 1991) (citing Mistretta v. United States, 488 U.S. 361, 382 (1989)). For a general discussion of the implications of the *Mistretta* decision, see Buffington, *Comment: Separation of Powers and the Independent Governmental Entity After Mistretta v. United States*, 50 La. L. Rev. 117 (1989).

[144] ___ U.S. ___, 111 S. Ct. 1752 (1991).

[145] ___ U.S. at ___ [citations omitted].

[146] *See* Taintor, *Federal Agency Nonacquiescence: Defining and Enforcing Constitutional Limitations on Bad Faith Agency Adjudications*, 38 Me. L. Rev. 185, 248-50 (1986) (discussing problem of reconciling administrative agencies' dual exercise of prosecutorial and adjudicative functions).

In *Winthrow v. Larkin,*[148] the United States Supreme Court reviewed an injunction against a contested Wisconsin administrative hearing on professional misconduct by physicians.[149] The Court recognized that the mere combination of investigative and adjudicative functions within a physicians' State Examining Board was insufficient to violate due process.[150] The simple fact that Board members had viewed evidence during investigative procedures could not overcome the "presumption of honesty and integrity in those serving as adjudicators"[151] and was an inadequate basis for impugning the fairness of the later adversary hearing.[152]

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[147] Playter v. FAA, No. 90-3420 (6th Cir. May 16, 1991).

[148] 421 U.S. 35 (1975).

[149] *Id.* at 59.

[150] *Id.* at 47. *See also* Richardson v. Perales, 402 U.S. 389, 410 (1971) (upholding agency hearing procedures despite social security hearing examiner's development of facts); Porter County Chapter v. Nuclear Regulatory Comm'n, 606 F.2d 1363, 1371 (D.C. Cir. 1979) (permitting interrelation of functions without violating due process). *But see* Federal Trade Comm'n. v. Atlantic Richfield Co., 567 F.2d 96 (D.C. Cir. 1977) (obligation to keep investigative and adjudicative roles separate to preserve judicial fairness and investigative vigor). In *Atlantic Richfield*, the court sidestepped the issue of how much separation is necessary by remanding the case to the FTC for a determination of the agency's interpretation of its own prosecutorial and adjudicative subpoena processes. 567 F.2d at 106. Subsequently, the FTC decided that complaint counsel could obtain access to documents obtained during the Commission's investigative process without leave of the administrative law judge adjudicating the matter and without notice to the adjudicative respondent. *See also* Appeal of FTC Line of Business Report Litigation, 595 F.2d 685, 707-08 (D.C. Cir. 1978) (unfairness of agency use of its own investigative documentation in adjudicative hearing, leaving unclear the precise limitations, if any, on the commingling of adjudicative and prosecutorial functions in the collection of evidence by agencies).

[151] 421 U.S. at 47. *See* Federal Trade Comm'n. v. Cement Institute, 333 U.S. 683 (1948) (commission not disqualified from adjudication despite members' prior ex parte investigations); *Porter County Chapter*, 606 F.2d at 1371 (combination of adjudicative with other functions within agency not violative of due process unless sufficient inherent bias); Ash Grove Cement Co. v. Federal Trade Comm'n, 577 F.2d 1368, 1377 (9th Cir. 1978) (cement company unable to overcome presumption of fairness of adjudicative enforcement procedures). *But see*, American Cyanamid Co. v. Federal Trade Comm'n, 363 F.2d 757 (6th Cir. 1966) (vacated FTC holding because of commission chairman's former investigative activities as chief counsel of Senate subcommittee); Trans World Airlines v. Civil Aeronautics Bd., 254 F.2d 90 (D.C. Cir. 1958) (adjudicator disqualified for prior involvement with issue as Postmaster General).

[152] *Id.* at 55.

## 2. Due Process and the Disinterested Adjudicator

Regardless of whether functions are separated or commingled, due process requires that adjudicative decisionmakers be impartial and neutral. During the October Term, 1972, the Supreme Court decided two cases disqualifying adjudicators because of their pecuniary interest in the matters to be decided by them.[153] In *Ward v. Village of Monroeville,*[154] the Court found that a person tried for traffic offenses was denied due process under the Fourteenth Amendment when the decisionmaker was a mayor, responsible for village finances, who provided a substantial portion of village funds from fines levied in his court .[155] The defendant was "entitled to a neutral and detached judge in the first instance,"[156] regardless of the availability of appellate procedures.[157]

Later that term, in *Gibson v. Berryhill,*[158] the Court disqualified a state optometry association from review of professional misconduct charges against optometrists due to the association's direct pecuniary interest in the outcome.[159] The optometry association, composed of private practitioners, sought to bar half the optometrists in the state from practice due to their employment with a corporate competitor.[160] The Court affirmed the district court's finding that the optometry association was "so biased by prejudgment and pecuniary interest" that the hearings pertaining to the revocation of the appellees' licenses were constitutionally infirm.[161]

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[153] For a discussion of the necessity for a disinterested adjudicator as part of due process, see Redish and Marshall, *Adjudicatory Independence and the Values of Procedural Due Process*, 95 Yale L. J. 455, 491-503 (1986) (distinguishing between pecuniary interest, personal bias, and predisposition impediments to adjudicatory fairness and independence).

[154] 409 U.S. 57 (1972).

[155] *Id.* at 61-62. *See* Tumey v. Ohio, 273 U.S. 510, 523 (1927) (judge with direct, personal, substantial bias against defendant violates due process).

[156] 409 U.S. at 61-62.

[157] *See Tumey*, 273 U.S. at 522 (recognizing general rule disqualifying judge with interest in outcome of controversy).

[158] 411 U.S. 564 (1973).

[159] *Id.* at 578.

[160] *Id.* at 571.

[161] *Id.* at 578. *See also* United Church of the Medical Center v. Medical Center Comm'n, 689 F.2d 693, 699 (7th Cir. 1982) (commission disqualified as adjudicator due to its financial stake in outcome of title reverter proceedings). *But see*, Hammond v. Baldwin, 866 F.2d 172, 177 (6th Cir. 1989) (citing *Ward* and *United Church*, but no due process violation for agency's alleged general bias favoring state interest in outcome).

## B. APA Requirements

The formal adjudication provisions of the Administrative Procedure Act implement constitutional due process protections and go beyond minimum constitutional requirements. Accordingly, agency procedures meeting APA requirements also satisfy constitutional requirements.

The Administrative Procedure Act's formal adjudication requirements contained in sections 554-557[162] apply to decisions of an adjudicatory character[163] required by statute to be made on the record after an opportunity for hearing.[164] The procedures for decisions on civil penalties and certificate actions clearly meet these requirements for formal APA adjudication.[165]

The APA formal adjudication provisions contemplate a trial-type hearing before an administrative law judge independent of agency control,[166] followed by an "initial" or "recommended" decision by the ALJ with a subsequent, usually discretionary, administrative appeal to the policy-making authority constituting the agency.[167]

The APA, like the Constitution, recognizes the legitimacy of policy control over agency adjudication. This justifies some compromises with pure neutrality.[168]

Although the Constitution does not directly address the issue of separation of powers within administrative agencies, section 554(d) of the Administrative Procedures Act (APA)[169] prohibits agency employees or agents from engaging in prosecutorial or investigative functions in the same or related case in which such employees or agents participate in adjudicatory[170] agency functions.[171] The APA requires that employees performing adjudicative responsibilities may not "be responsible to or subject to the supervision or direction of an employee or agent engaged in the performance of investigative or prosecuting functions for an agency."[172]

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[162] 5 U.S.C. §§554-558 (1988).

[163] Decisions of an adjudicatory character involve applying preexisting rules to concrete factual situations.

[164] 5 U.S.C. §554(a) (1988).

[165] *See* 49 U.S.C. §§1429(a);1429(c)(3); 1471(a)(1); 1471(a)(3)(D); 1475(d)(1) (1988) (providing for orders only after hearings or hearings on the record).

[166] *See* 5 U.S.C. §5372 (1988) (ALJs compensated independently of agency recommendations or ratings); 5 U.S.C. §7521 (limiting grounds for adverse agency action against ALJs); 5 U.S.C. §3105 (limiting duties of ALJs).

[167] The policymaking authority in the case of a single administrator agency like the FAA is the administrator, and in the case of multimember agency like the National Transportation Safety Board is the board itself. The ultimate authority of an agency can be delegated, just as the Secretary of Transportation who has the statutory authority under the Federal Aviation Act has delegated the authority to the administrator, or, as the EPA administrator does, to judicial officers under 40 CFR §22.04(b)(3). Similarly, a multimember agency can delegate its authority to panels, as the National Labor Relations Board does.

[168] *Accord* Harold H. Bruff, *Specialized Courts in Administrative Law*, 43 Admin.L.Rev. 329, 345-52 (1991) (contrasting agency adjudication with Article III adjudication).

[169] 5 U.S.C. §554(d) (1988).

When an agency commingles functions to a degree not permitted by §554(d), decisions tainted by the commingling are subject to invalidation by a reviewing court under 5 USC §706(2)(D) (without observance of procedure required by law).

In *Wong Yang Sung v. McGrath*,[173] a *habeas corpus* proceeding involving the deportation proceedings, the United States Supreme Court recognized that one of the fundamental purposes of the APA was "to curtail and change the practice of embodying in one person or agency the duties of prosecutor and judge."[174] The Court acknowledged that though the APA "did not go so far as to require a complete separation of investigating and prosecuting functions from adjudicating functions,"[175] the Immigration Service's deportation proceedings did not comport with APA requirements proscribing commingling of adjudicatory and prosecutorial and investigative functions.[176]

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[170] Section 554(a) of the APA provides that the section applies "in every case of adjudication required by statute to be determined on the record after opportunity for an agency hearing,..." 5 U.S.C. §554(a). Several cases have recognized that section 554(d) of the APA applies only to "adjudications", not "rulemaking" activities. Porter County Chapter v. Nuclear Regulatory Comm'n., 606 F.2d 1363, 1367 (D.C. Cir. 1979); Hercules, Inc. v. Environmental Protection Agency, 598 F.2d 91, 117 (D.C. Cir. 1978); Hoffman-La Roche, Inc. v. Kleindienst, 478 F.2d 1, 13 (3d Cir. 1973). *See also*, National Labor Relations Bd. v. Bell Aerospace Co., 416 U.S. 267 (1974) (distinguishing adjudicatory from rulemaking functions); Securities & Exchange Comm'n. v. Chenery Corp., 332 U.S. 194 (1947).

[171] In pertinent part, section 554(d) states that: "An employee or agent engaged in the performance of investigative or prosecuting functions for an agency in a case may not, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review pursuant to section 557 of this title, except as a witness or counsel in public proceedings." 5 U.S.C. §554(d). *See* Amos Treat & Co. v. Securities and Exchange Comm'n., 306 F.2d 260, 266-67 (D.C. Cir. 1962) (separation of investigatorial and prosecutorial staff from adjudicative function necessary).

[172] 5 U.S.C. §554(d)(2)

[173] 339 U.S. 33 (1950).

[174] *Id.* at 41. The Attorney General's Committee on Administrative Procedure recognized that "when a controversy reaches the stage of hearing and formal adjudication the persons who did the actual work of investigating and building up the case should play no part in the decision." Rep. Atty. Gen. Comm. Ad. Proc. 56 (1941), S. Doc. No. 8, 77th Cong., 1st Sess. 56 (1941).

The limitation on commingling of functions in §554(d) reflects two congressional concerns: acquisition of information ex parte by an adjudicatory decisionmaker, and loss of objectivity and impartiality because of a former or simultaneous role as an advocate.[177] The *Wong Yang Sun* Court embraced the two purposes and urged interpretation of §554(d) consistent with its purpose as well as according to the letter of the statutory language.[178]

The federal courts have strictly applied the language of APA §554(d), to separations within agencies while granting ultimate agency decisionmakers[179] nearly complete flexibility to perform both prosecutorial/investigatory and adjudicatory functions.

In *Blinder, Robison & Co. v. SEC*,[180] the United States Court of Appeals for the D.C. Circuit found no violation of §554(d) when the SEC successfully sought sanctions against a broker dealer in district court and then subsequently heard the case in its administrative adjudicatory capacity. The court discussed the Supreme Court's decision in *Withrow v. Larkin*,[181] sharply distinguishing the commingling of functions before a lower level hearing officer, prohibited by §554(d) and commingling of functions before the administrative agency itself. The *Withrow* court had distinguished administrative agency practice from the situation of a judge performing combined functions. The contrary outcome on the SEC case, in the opinion of the D.C. Circuit would "work a revolution in administrative (not to mention constitutional) law...."[182]

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[175] 339 U.S. at 46. *See also* Twigger v. Schultz, 484 F.2d 856 (3rd Cir. 1973) at 860 n.3 (quoting Wong Yang Sung v. McGrath, 339 U.S. 33, 41 (1950)). The Attorney General's Committee concluded that complete separation of functions would be overly burdensome and not necessarily the best means of overcoming adjudicatory bias and prejudice. Rep. Atty. Gen. Comm. Ad. Proc. 60 (1941), S. Doc. No. 8, 77th Cong., 1st Sess. 60 (1941). *See also*, Rep. Atty. Gen. Comm. Ad. Proc. 207 (1941), S. Doc. No. 8, 77th Cong., 1st Sess. 207 (1941) (additional views and recommendations of Messrs. McFarland, Stason, and Vanderbilt) ("It is only the formal adjudication of contested matters--the taking of evidence and the decision of contested cases--that requires separation").

[176] *Id.* at 45. The immigration inspector who presided at the hearing investigated similar cases, was responsible for cross-examination and for presenting evidence on behalf of the INS.

[177] *See* Grolier, Inc. v. FTC, 615 F.2d 1215, 1219-1220 (9th Cir. 1980) (reviewing legislative history and Attorney General's report).

[178] 339 U.S. 33, 41-42 (1950).

[179] Administrators, boards, or commissions.

[180] 837 F.2d 1099 (D.C. Cir. 1988).

[181] 421 U.S. 35 (1975).

[182] 837 F.2d at 1107.

In *Grolier, Inc. v. FTC,*[183] the United States Court of Appeals for the Ninth Circuit held that an ALJ who formerly had been an attorney advisor for the FTC potentially was disqualified from hearing a case as an ALJ on which he had advised a commissioner while he was an attorney advisor. It remanded for a factual determination of whether the ALJ actually had involvement in the same or related case while he was an attorney advisor, imposing the burden of showing such prior acquaintance on the challenger.[184] The *Grolier* decision is as important for its limitations on the 554(d) prohibition as for its holding. It held that the prohibition on commingling of functions would not extend to attorney advisors as long as they are acting as attorney advisors. The FTC has argued that a close relationship between attorney advisors and agency members requires that attorney advisors be treated under §554(d) just as agency members, so that the attorney advisors may advise agency members freely on the full range of their responsibilities. The Ninth Circuit responded, "this argument would be compelling if made on behalf of an attorney-advisor or other FTC employee who must counsel the member at both the investigative and decision-making stages of a cases. But ALJ Von Brand is no longer an attorney advisor...."[185]

The court noted the overwhelming practice in administrative agencies of performing within one organization a number of responsibilities that democratic political theory usually seeks to separate. [186]

In *Pangburn v. CAB*,[187] the United States Court of Appeals for the First Circuit held that involvement by the CAB in a factual determination of accident cause, in its accident investigation role, did not preclude the board from hearing an appeal of a certificate suspension determination by a pilot involved in the accident.[188] The court noted that the board, in hearing the appeal, did not consider itself bound by factual determinations made in the course of an accident investigation. [189] The court based its conclusion on the well-settled proposition, "that a combination of investigative and judicial functions within an agency does not violate due process."[190]

In *Twigger v. Schultz*,[191] the United States Court of Appeals for the Third Circuit invalidated the suspension on a customs broker's license because the district director of customs presided over an adjudicatory hearing of a complaint that he had recommended to the Commissioner of Customs. The court suggested that commingling an investigatory function with an adjudicatory function is worse than commingling a prosecutorial and adjudicatory function, because the affected person is unable to offer evidence in opposition to that which the investigator received ex parte.[192]

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[183] 615 F.2d 1215 (9th Cir. 1980).

[184] 615 F.2d at 1221.

[185] 615 F.2d at 1220.

[186] 615 F.2d at 1217.

[187] 311 F.2d 349 (1st Cir. 1962).

[188] 311 F.2d at 356.

[189] 311 F.2d at 356.

[190] 311 F.2d at 356.

[191] 484 F.2d 856 (3rd Cir. 1973).

The case law says that it does not violate either the APA or the Constitution for the Administrator of the FAA to make final decisions in cases prosecuted by lower level personnel reporting to the administrator. *Grolier* says that an FAA employee involved as an investigator or prosecutor could not be the hearing officer. *Twigger* says that the investigator could not be the hearing officer or another first level decisionmaker. *Grolier* also says, however, that attorney advisors might both prosecute and advise the administrator. Indeed, the only statutory argument that can be made in favor of a requirement to separate functions further is that the phrase "performing adjudicative responsibilities" in that part of §554(d) prohibiting a unitary reporting relationship includes advising the ultimate decisionmaker. This reading is undercut by *Grolier*, however.

One commentator urged that formality not be carried to the extreme of depriving decisionmakers of informed advice from higher level agency personnel, even if they are in the chain of command of agency prosecutors.[193]

The only conceivable bias argument that seems to have any merit in the aviation civil penalty context is an argument that the FAA administrator's responsibility for the air traffic control system gives the administrator a bias in favor of air traffic control personnel and against pilots or airlines when the two have conflicting interests.[194]

## VI. Arguments in Favor of NTSB Authority

The preamble to Conference Recommendation 90-1 introduced the arguments in favor of transferring adjudicatory authority to the NTSB thus:

> "the NTSB currently adjudicates violations of federal aviation law in the context of certificate proceedings, so it already has experience in the substantive area, as well as

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[192] 484 F.2d at 861.

[193] *See* Michael Asimow, *When the Curtain Falls: Separation of Functions in the Federal Administrative Agencies*, 81 Colum. L. Rev. 759, 800-801 (reviewing APA and Constitutional requirements and recommending that supervisors of agency advocates remain available to advise on decisions, noting that this is the widespread practice).

> established and respected adjudicatory procedures. A transfer of these proceedings to the NTSB would place almost all administrative sanctions for aviation safety violations in one forum. Moreover, the independence of the NTSB from the prosecuting agency would promote the appearance of fairness, by formally separating the agency prosecuting the case from the one adjudicating it."[195]
>
> These and other arguments are developed further in the following sections.

## A. Separation of Powers Principles

Some proponents of NTSB adjudicatory authority argue that constitutional due process or separation of powers principles, or APA statutory separation of functions principles require that adjudicatory authority be removed from the FAA. As the analysis in part V of this report shows, there is no substance to these arguments legally. It is entirely consistent for the FAA to have adjudicatory authority as long as it meets the requirements of APA §554(d).

The deeply-felt separation of functions argument is better understood as a perceived fairness argument, rather than a legal argument based either on the Constitution or on the APA.

## B. Constituencies Trust NTSB More than FAA

Professor Fallon placed greatest emphasis in support of his recommendation for NTSB responsibility on fairness and appearance of fairness, more particularly on trust by affected parties.[196] He concluded that NTSB would be perceived as more fair by constituencies angered by FAA substantive enforcement policies and administration of procedural aspects of the civil penalties demonstration program.[197] He did, however, embrace the

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[194] The administrator's responsibility for air traffic control is discussed in §VI(C) as an argument in favor of transferring adjudicatory authority to the NTSB.

[195] Recommendation 90-1, "Civil Money Penalties for Federal Aviation Violations," 55 Fed.Reg. 34209 (Aug. 22, 1990) (to be codified at 1 CFR §305.90-1.)

[196] Fallon Report at 24-25.

[197] Fallon at 24.

goal of "smooth, simple, unitary system of administrative adjudication, subject to just one main set of procedural rules."[198]

The major part of the separation of functions problem with aviation civil penalties is a perceptions problem.

Most pilot respondents are people of some stature in their communities, do not think of themselves as law breakers, yet are unsophisticated in their knowledge of the structure of federal government agencies. They react strongly to getting hauled before an administrative agency and, when the ultimate trier of fact and law appears to work for the same agency as the prosecutor, the process seems unfair. This problem, of course, cannot be remedied unless all pilot adjudicatory authority is in the NTSB.

The airline community is primarily concerned with enforcing airport security rules and aircraft maintenance rules and is less concerned with pilot enforcement actions. A few carriers do represent their pilots in enforcement proceedings, and those airlines have concerns similar to those expressed by pilot representatives.

Airline industry concerns with civil penalty administration are much increased by the FAA's test object program. The airline community perceives that the FAA engaged in overly militant enforcement of technical airport security requirements for largely political reasons.[199] In the view of some airlines, the launching of the test object program abrogated a negotiated arrangement reached in 1987, thus depriving airline participants of the bargain struck in regulatory negotiation. The test object program subjects persons responsible for airport security screening systems to penalties for failure of the systems to detect all test objects. Test objects are simulated bombs, guns, and other prohibited items.[200]

These concerns about FAA fairness are increased by the perception that some large civil penalties for maintenance violations were announced so as to increase political and public relations fallout rather than to solve real maintenance problems. These concerns may explain, to some degree, the ATA's vigorous opposition to promulgation of procedural rules without notice-and-comment rulemaking.

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[198] Fallon at 26.

[199] *See* Continental Airlines Statement Appendix (FAA press releases announcing names of airlines and amounts of penalties without mentioning entitlements to hearings and final decisions based on hearing records).

[200] *See generally* In the Matter of Continental Airlines, Inc., FAA Order No. 90-18 (August 22, 1990) at 14-15 (describing test object program and finding it not arbitrary and capricious).

Affected constituencies generally perceive that the FAA has been insensitive to adjudicatory procedural protections in the past.[201]

After the public hearing in June, the airline industry significantly increased its opposition to the civil penalty program. Through experience gained primarily in about 2,000 airport security test object cases, the airline industry became convinced that the FAA will not follow its own procedural rules. Therefore, some members of the industry believe solutions to underlying procedural deficiencies must lie in imposing some independent authority over the procedure.

The airline industry believes that the existing procedural rules allow the presentation of affirmative defenses and also allow discovery in support of affirmative defenses. Nevertheless, the FAA has refused to make available for deposition subpoenaed witnesses even in the face of an order from the presiding ALJ.[202] This deprives respondents of the right to make an adequate administrative record. Flouting of the rules is increased, the airline industry believes, by the expectation that almost any position taken by FAA prosecutors will be sustained by the administrator on administrative appeal.

The airline community is more accustomed to an enforcement model in which enforcement responsibility is totally separated from judging and judge advising responsibility. Under the old CAB, the Bureau of Enforcement maintained a virtually total separation from the board's general counsel. The board exercised appellate authority, advised by the general counsel. The Bureau of Enforcement was responsible for the prosecutorial function. The same kind of formal separation is manifest in the DOT economic regulation procedures. A "senior career official" makes the decision, advised by a designated lawyer. Senior career official decisions are subject to discretionary review by the Secretary and Assistance Secretary for Policy and International Affairs. The advising lawyer is insulated from the "public counsel" who commences proceedings. This procedure is followed in route authority cases.[203]

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[201] For example, some FAA officials and ALJ Yoder had a running battle over the applicability of Part 300 to hazardous materials violation civil penalty proceedings under 49 U.S.C. §1809(a)(1). See NL Industries, Inc., Docket No. 84-29 HM, Order served Feb. 13, 1986 (In Part 13 matters, Part 300 applies to ex parte contact and separation of functions issues; deleting reference to APA); id. order served Dec. 7, 1989 (accepting assurances of Part 300 compliance; refusing to lift sanctions against FAA attorney for opposing application of Part 300); id., order served Dec. ___, 1988 (FAA Administrator decision on appeal; agency not ALJ determines hearing procedures; Part 300 does not apply to FAA hazardous materials proceedings; ALJ cannot expand procedural requirements beyond those of Part 13; vacating discipline against FAA attorney).

[202] See FAA v. American Airlines, Docket Numbers CP89EA0119, EP89GL0121, CP89SW0122, CP89SW0123, CP89So0124, CP89GL0125, CP89GL0126, CP89WP0129, CP89SW0460, CP91SW0142 (letter from FAA regional counsel, October 8, 1991).

## C. The Current Cooperative Spirit at the FAA May Not Last

The D.C. Circuit's decision, and the changes in the FAA procedural rules satisfied some immediate concerns of the airline community. The airline community is very uncomfortable at being at the mercy of a change of regimes or political climate. Certificate actions almost never occur with major trunk airlines and, thus, forum shopping is not an issue. On the other hand, there is great mistrust of the FAA and, thus, opposition to any increase in FAA scope over enforcement proceedings.

While the present administrator of the FAA and chief counsel are oriented toward constructive relationships with regulated groups and to problem solving approaches rather than confrontation, the approach represented by the initial procedural rules for the civil penalty program and by the press releases issued on airline civil penalty complaints is institutionally deep seated and likely to manifest itself again under different leadership. Regulated groups need institutional protection from this inflexibility.

## D. The FAA Will be Biased in Favor of its Own Air Traffic Control Personnel

One of the strongest arguments for treating institutional arrangements for aviation safety differently from institutional arrangements for other programs is the fact that the FAA has operational responsibility for the air traffic control system. Making the FAA administrator the ultimate decisionmaker in enforcement actions brought against airlines, airports, pilots, and mechanics gives the administrator a perceived conflict of interest. There are conceivable circumstances in which the administrator may exonerate a pilot only by finding fault with one of his own subordinates in the air traffic control system.[204] Similar, though more attenuated, problems exist with respect to other FAA operational functions, such as certification of airmen and aircraft. It is conceivable that a civil penalty proceeding might raise questions about proper performance of certification functions as well as questions about compliance by the person against whom civil penalties are proposed.

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[203] 50 Fed. Reg. 2374 (1985) (adding rules of procedure for airline economic regulation functions transferred from CAB, including 14 CFR §302.22a (DOT decisionmaker), and 14 CFR §300.4 (separation of functions). *See* Discovery Airways, Inc. and Mr. Philip Ho, Docket 46760, Order Served May 25, 1990 Slip Op. at 2 n.2 (Assistant Secretary for Policy and International Affairs serves as decisionmaker pursuant to 49 CFR §1.56(i)(1); 14 CFR §302.22a(c), (c)); *Id.*, order served May 16, 1990 (ordering public counsel to file list of ex parte contacts potentially violating 14 CFR §300.2).

Not only is the FAA administrator protective of the FAA air traffic control system as a policy matter; there also are tort liability questions. If a pilot is found liable for violating regulations, the likelihood of a judgment against the government for air traffic control lapses is less. Under the present organizational arrangements the same officials who advise the administrator on administrative appeals of civil penalties also are involved in tort litigation involving the FAA as a defendant. Frequently, exonerating a person against whom civil penalties have been assessed potentially weakens the agency's position in tort litigation.

While there is a weak parallel argument in the other direction, arising from potential conflicts between the NTSB's accident investigation role and its adjudicatory role, the percentage of certificate cases in which an accident is involved is relatively small,[205] while the proportion of civil penalty cases in which air traffic control personnel responsibility is at issue is relatively large.

The FAA is nearly unique in its exercise of operational responsibility, which makes it a co-actor with persons or entities subject to its regulatory jurisdiction. This special characteristic provides plausible justification for treating the FAA differently from other agencies adhering to the unitary enforcement model. Only the Coast Guard has as strong an operational role in the same regime as those potentially subject to civil penalty authority by the same agency.[206]

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[204] Continental Airlines contrasts In re Terry and Menn, FAA Order No. 91-12 (May 14, 1991), and Administrator v. Holstein, NTSB Order No. EA-2782 (August 31, 1988) (no pilot sanction when pilot repeats erroneous interpretation of clearance and controller does not correct situation). The FAA only takes such circumstances into account for mitigation purposes. Continental Airlines statement at 3. *See* statement of Michael J. Pangia before the Administrative Conference of the United States, June 19, 1991 at 1 (noting conclusion of aviation safety reporting system that majority of pilot/controller errors are due to miscommunication or misunderstandings between air traffic controllers and pilots, which may leave pilots vulnerable to civil penalties for mistakes by FAA personnel). *See also* supplementary statement by Daniel D. Campbell at 14-15 (citing Administrator v. Ryan, NTSB Order EA-3238 (1990) (involving failure by FAA to produce tapes that might have supported pilot's argument regarding clearance, while producing tapes supporting FAA version of near miss incident).

[205] But see Janka v. DOT, 925 F.2d 1147 (9th Cir. 1991) (NTSB not prohibited from hearing testimony of NTSB investigator in limited circumstances, although Board policy discourages receiving such testimony so as to separate investigation and adjudication functions).

## E. The FAA Frequently Controls Material Evidence

Related to the conflict of interest argument is an argument that the FAA frequently has the evidence needed to exonerate a person against whom civil penalties are proposed. This is particularly true in the case of airmen who allegedly violated air traffic control regulations. It also conceivably is the case with respect to airport security violations. In one example offered to the author, a pilot was subjected to civil penalties for penetrating a terminal control area without clearance. The pilot claimed that he had been cleared into the TCA. Tapes produced by the FAA after considerable delay omitted the portion of the flight that would have supported the pilot's position.

While production of evidence is under the control of the ALJ, who can impose sanctions for failure to disclose material evidence under the FAA's procedural rules,[207] placing ultimate administrative appellate authority in the FAA administrator raises the risk that the administrator would not uphold ALJ action to compel disclosure of evidence. Placing adjudicatory authority in an independent agency would avoid this risk.

## F. The NTSB, Like the FAA, Has Safety Responsibility

One of the factors used by the Supreme Court in *Martin v. OSHRC* for resolving disputes among agencies with potentially overlapping authority for adjudicating civil penalties was the degree to which each agency has overall responsibility for achieving statutory goals. NTSB is different from other potential adjudicatory agencies in split enforcement models in that it does have substantial programmatic responsibility. The NTSB has responsibility for evaluating the safety of the National Aviation System. This gives it a greater measure of expertise and more concern with enforcement actions than it would have if it were a purely adjudicatory agency like OSHRC, MSHRC, and the MSPB. This NTSB responsibility for safety essentially serves to weaken arguments in favor of FAA adjudicatory responsibility under the unitary model.

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[206] Hypothetically, a Coast Guard-licensed mariner might be subjected to sanctions for an error that partially resulted from failure by Coast Guard operational personnel to place or maintain a navigational aid properly.

[207] 14 CFR §13.220(m) (1991) (sanctions for failure to comply with discovery obligations).

In addition, there is an argument that, at least in pilot cases and maintenance cases, the NTSB can perform its safety oversight function better if it has some involvement in the enforcement process.

The argument in favor of distinguishing pilot and maintenance cases from other enforcement cases is that pilot cases involve safety issues that are similar to those involved in accident investigations. In a sense, involving the NTSB in these cases raises NTSB consciousness of safety matters that otherwise would be visible only after an accident has happened.[208] This argument could justify retaining certificate actions at the NTSB while leaving everything else, including pilot penalty cases, at the FAA. Certificate cases involve the more serious claims of pilot violation and therefore the more serious safety issues.

## G. NTSB Adjudication Makes it Easier to Administer Prohibitions On Ex Parte Contact

An argument mobilized by Administrative Law Judge Yoder cuts off potentially productive settlement discussions because of a concern with ex parte contact.[209] The argument is that the administrator and chief counsel may not be involved in discussing settlement of cases pending before ALJs because both of them may become involved in an administrative appeal of an ALJ decision. Class settlements, of course, only can be meaningfully explored at this policy level. This apparent ex parte contact problem would be eliminated if the administrative appeal authority were in another agency.

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[208] *See* supplementary statement of Daniel D. Campbell (identifying cases involving sufficiency of clearance readbacks from pilot to tower; potential anomalies and operation of visual approach slope indicators; impact of slipshod or dishonest maintenance practices); statement at 3.

[209] American Airlines, FAA Dockets Cp89EA0119, CF89GL0121, CP89SW0122, CP89SW0123, CP89SO0124, CP89GL0125, CP89GL0126, CP89WP0129, CP89SW0460 (civil penalty actions) (ALJ order served June 3, 1991) (ordering disclosure of documents concerning settlement discussions with Deputy Chief Counsel); American Airlines, FAA Dockets Cp89EA0119, CF89GL0121, CP89SW0122, CP89SW0123, CP89SO0124, CP89GL0125, CP89GL0126, CP89WP0129, CP89SW0460 (civil penalty actions) (ALJ order served Dec. 12, 1990) (same).

## H. Adjudicatory Responsibility Should not be Bifurcated

Politically, some interested parties argue, it is unlikely that certificate adjudication will be removed from the NTSB, so a decision to keep civil penalty authority in the FAA is tantamount to a decision to bifurcate. The splitting of cases between the NTSB and the FAA leads to forum shopping. This is particularly likely to be evident in situations, like the present one, in which the limitation period is different between the two adjudicatory tribunals. The NTSB has a 6-month "stale complaint" rule.[210] The FAA has a 2-year rule.[211] An FAA attorney bringing a case after the 6-month period has lapsed obviously will bring it as a civil penalty case to get the case heard.

Ultimately, splitting adjudicatory responsibility between civil penalties cases and certificate actions may permit virtually all adjudicatory authority to migrate to the FAA because the FAA, as a matter of policy, could essentially stop pursuing enforcement through certificate actions and substitute civil penalties.

## I. The NTSB's Procedural Rules are Better Than the FAA's

Pilot groups believe that NTSB's discovery rules are better than the FAA's. These groups believe that the FAA discovery rule permits too much discovery against persons against whom civil penalties are assessed.[212] Respondent pilots do not need discovery; they take discovery under the Freedom of Information Act. They argue that as individuals, they lack the resources to respond to burdens of discovery requests from the agency. On the other hand, evidence of discovery abuses by the FAA is lacking, and remedial action could be deferred until there is clearer evidence of abuse.

Airlines expressed the view that FAA rules are too rigid with respect to mitigating penalties.[213] These airlines believe that broader NTSB review authority permitting amendment, modification, or reversal if the board "finds that safety and air commerce or air transportation and the public interest do not require affirmation of the administrator's order" represents a better approach, noting that flexibility in assessing penalties is the hallmark of virtually all aspects of aviation safety except airport security.[214]

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[210] 14 CFR §821.33 (1991).

[211] 14 CFR §13.208(d) (1991) (good cause permits extension).

[212] The point is not that the discovery rules permit more discovery against some parties than against others; the point is that even-handed discovery power impacts some parties more then others.

[213] *See* Comments of Continental Airlines, Inc., Conference hearing, June 19, 1991 (citing FAA chief counsel memorandum suggesting that only mitigating factor is ability to pay; citing In re Northwest Airlines, Inc., FAA Order No. 90-37 (served Nov. 7, 1990) in support of proposition that FAA administrator will enforce penalty guidelines on ALJs; citing In re Dawn

## J. The FAA Fails to Permit Appropriate Challenges to its Substantive Rules in the Course of Adjudication

An interested party may challenge an agency rule in two different ways. The person may participate in rulemaking proceedings and seek "preenforcement review", challenging the rule in the abstract.[215] Alternatively, a party to an adjudicatory proceeding may challenge the rule as applied in a particular proceeding.[216] One of the sharpest controversies over the civil penalty adjudication relates to the desire by some airlines to challenge the legitimacy of the test object and zero-tolerance requirements,[217] in the context of defending against civil penalties imposed for violation of those requirements.[218] In addition to the controversy over the deposition of a senior FAA official, resisted on *Morgan v. United States* grounds by the FAA,

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M. Lewis, FAA Order No. 91-3 (Feb. 4, 1991) supporting proposition that ability to pay is only ground for reduction of sanction). Continental Airlines statement at 10-11.

[214] Continental Airlines statement at 15 (quoting 49 U.S.C. App. §1429(a); Continental Airlines statement at 11 (contrasting operation of unairworthy aircraft).

[215] *Compare* Abbott Laboratories v. Gardner, 387 U.S. 136, 151 (1967) (limits on preenforcement review) *and* Geller v. FCC, 610 F.2d 973 (D.C. Cir. 1979) (noting that rule can be challenged when it is applies as well as when it is adopted) *and* Diamond Shamrock, 580 F.2d 670, 673-74 (D.C. Cir. 1978) (allowing effluence regulations to be reviewed only in the context of an enforcement proceeding; rejecting preenforcement review) *with* 42 U.S.C. sec. 7607(b)(2) (1988) (foreclosing challenge to air pollution rule unless made within 60 days of publication in Federal Register) *and* Eagle-Picher Industries v. U.S.E.P.A., 759 F.2d 905 (D.C. Cir. 1985) (applying 42 U.S.C. sec. 9613(a) (1982) requiring that petitions to challenge CERCLA rules be filed within 90-days from publication).

[216] The relationship between these two forms of challenges to rules has been debated recently in the context of statutory requirements that challenges to rules be made, if at all, in the preenforcement context.

[217] These requirements subject responsible persons to civil penalties for failing to detect all test objects passed through airport security systems.

[218] See generally, FAA Motion to Supplement Motion to Quash Subpoena, Federal Aviation Administration v. Alaska Airlines, Inc., CP89AL0295 (88AL720077), CP89NM0296 (88NM710163), CP89NM0299 (88NM710106), CP89NM0307 (88NM710117), CP89NM0470 (89NM710017) (filed August 9, 1991) (reviewing controversy [hereinafter "FAA Motion to Quash"].

agency prosecutors apparently take the position that the airline is not entitled to develop a record in support of its claim that the requirement is arbitrary and capricious.[219] On the other hand, the administrator has considered the arbitrary and capricious argument and has provided enough rationale to permit meaningful judicial review of the legitimacy of the requirements.[220]

## VII. Arguments in Favor of Retaining the Authority at FAA

The preamble to Conference Recommendation 90-1 introduced the arguments in favor of retaining civil penalty adjudication authority at the FAA like this:

> "Any transfer of civil penalty adjudicative responsibility to the NTSB would entail legislative consideration of whether and to what degree deference should be given by the Board to FAA policies and whether the FAA Administrator should be entitled to seek judicial review of adverse NTSB decisions. Moreover, retaining the adjudicative function in the FAA would allow for coordinated regulatory and enforcement policy in one agency, a model that is used by most federal agencies. If it is important to have hearings in both certificate and money penalty cases heard in the same forum, theoretically the former function could be transferred to the FAA. Although there has been criticism of the FAA's rules of practice, the agency is about to complete a rulemaking in which it has proposed significant changes in its rules. Finally, aviation safety and related enforcement are the chief missions of the FAA."[221]

These and other arguments are developed more fully in the sections that follow.

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[219] FAA Motion to Quash at 5-6 (arguing that ALJ lacks the authority to consider argument, and that development of a record in support of the argument is impermissible at the ALJ stage).

[220] See In the Matter of Continental Airlines, Inc., FAA Order No. 90-18 (August 22, 1990) at p.15 (quoted in FAA Motion to Quash at 9).

[221] Conference Recommendation 90-1, "Civil Money Penalties for Federal Aviation Violations," 55 Fed.Reg. 34209 (Aug. 22, 1990) (to be codified at 1 CFR §305.90-1.)

## A. FAA has Ultimate Responsibility for Safety and is Better Able to Make Safety-Policy Decisions Implicated in Enforcement Adjudications

The FAA administrator, as the delegate of the Secretary of Transportation, is the public official charged with responsibility for making the national aviation system safe. Realization of the goal of aviation safety necessitates giving responsibility and authority to the official to be held accountable. Aviation safety requires tradeoffs among the content of regulations, operational arrangements for the air traffic control system, and enforcement policy. Splitting enforcement responsibility artificially separates part of an overall matrix and impairs achievement of the safety goal.

If adjudicating a pilot case involves the adjudicatory agency in sorting through the details of air traffic control confusion, or questionable operating practices, the adjudicator getting exposure should be the person with safety responsibility, and the power to make changes.

## B. Most of the Arguments in Favor of Splitting Enforcement and Adjudication Have Been Rejected in the Context of Administrative Law Generally

Most of the arguments in favor of NTSB adjudicatory authority are arguments that would support separating the adjudication function from the prosecution function in any enforcement agency. These arguments generally have been rejected as the unitary enforcement model has become the norm. The Supreme Court's *Martin v. OSHRC* decision recognizes that split enforcement is a deviation from the norm.

## C. FAA has More Resources and Will Minimize Delay

Undeniably, the FAA is a much larger agency than the NTSB. This provides flexibility to reallocate resources, especially ALJ resources, to minimize delay in holding hearings and deciding appeals. The data submitted by the FAA chief counsel in the Conference hearing on June 19 reenforces the conclusion that efficiency would be served and delay minimized by preserving adjudicatory authority in the FAA.

The average time from request for hearing to ALJ decision under the FAA and the NTSB processes is a little longer for the FAA than for the NTSB. The average time from ALJ decision to appellate decision, however, appears to be significantly longer under the NTSB procedure than under the FAA process. Appellate timeframes under the NTSB procedure range from 15.2 months for opinion-and-order cases to 10 months for all types of appeals, compared with FAA appellate timeframes of 7.9 months (5.3 months when adjusted for cases affected by the 124-day "hiatus" period) for opinion-and-order cases and 5.5 months (3.9 months when adjusted for cases affected by the 124-day "hiatus" period) for all types of appeals.

There are several caveats or counter arguments. One was summarized by attorney Mark T. McDermott, arguing that the FAA has greatly increased its use of emergency case authority.[222] The general counsel of the National Transportation Safety Board, in a supplementary statement submitted at the request of the author of this report during the June 19, 1991 hearing, made several points. First, the statistics offered by the FAA chief counsel do not reflect standard statistical inference methodologies. Second, the statistics for FAA case processing include the earliest cases that moved through a pipeline that was new and uncongested, which may bias the results optimistically. Processing time for more recent FAA cases has increased to almost the same period of time as that offered by the FAA for NTSB appeals.[223]

## D. There is no Evidence of Unfairness or Bias in FAA Decisions

Statistics indicate that respondents participating in Administrative Law Judge (ALJ) hearings in the Federal Aviation Administrations (FAA) civil penalty process are more often successful than those appearing before a National Transportation Safety Board (NTSB) ALJ. In FAA ALJ hearings, less than one-third (31 percent or 51 of 166 cases) affirmed the FAA order as compared with over one-half (52 percent or 156 of 299 cases) of NTSB hearings. FAA hearings resulted in reversal or modification of the FAA order, in favor of respondents over two-thirds (69 percent or 115 of 166 cases) of the time while NTSB hearings only resulted in reversal or modification of the FAA order, in respondents' favor, less than one-half (48 percent or 143 of 299 cases) of the time.[224] These figures suggest that an ALJ hearing in the FAA's civil penalty process is more favorable to the respondent than a similar hearing before an NTSB ALJ.

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[222] Letter from Mark T. McDermott to Richard J. Leighton, June 25, 1991 (summarizing emergency cases as constituting 5 percent of the total in 1987-88, 6 percent of the total in 1988-89, 15 percent of the total in 1989-1990 and 20 percent of the total for the 8 months of October 1990 to June 1991). Letter at 2.

[223] Supplementary statement by Daniel D. Campbell at 6.

Regarding appeals of ALJ decisions, a significantly higher proportion of FAA appeals were dismissed in FAA appellate review (75 percent or 27 of 36 appeals) than in NTSB appellate review (48 percent or 33 of 69 appeals). Similarly, only about 25 percent (10 of 39 appeals) of respondent appeals before FAA appellate review were dismissed as compared to almost 40 percent (39 of 98 appeals) of respondent appeals in NTSB appellate review. Of those FAA appeals which reached decision on the merits, no significant statistical difference was evident between FAA and NTSB appellate forums (FAA prevailed about 75 percent of the time). Respondent appeals, however, were more favorable for respondents in FAA appellate review (31 percent success rate or 9 of 29 decisions) than in NTSB appellate review (mere 8 percent success rate or 5 of 59 decisions). While these figures support the proposition that FAA civil penalty review procedures are more favorable to respondents than the NTSB review process, the relatively small number of statistical events should temper any premature enthusiasm for a particular conclusion based on these data.

## E. There are Additional Structural and Procedural Alternatives if Authority is Retained at the FAA

Most of the legitimate objections to FAA adjudicatory authority can be addressed by changing the structure and the procedures for FAA hearings and administrative appeals. The possibilities addressed in §IX of this report can be considered.

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[224] Reversals of FAA orders were less statistically significant between FAA hearings (17 percent or 28 of 166 cases) and NTSB hearings (19 percent or 56 of 299 cases). Modifications of FAA orders, however, were more likely in FAA hearings (52 percent or 87 of 166 cases) than in NTSB hearings (29 percent or 87 of 299 cases).

## F. The Ultimate Protection of Procedural Fairness is Judicial Review, Which Operates Regardless of who Has Adjudicatory Authority

Ultimately, the courts protect persons subjected to enforcement actions against procedural unfairness. There is no reason to believe that the federal courts will not be as vigilant in ensuring FAA compliance with constitutional and statutory safeguards as they are with other enforcement programs. If the FAA does not maintain separation of functions, or if the administrator decides administrative appeals based on a bias in favor of air traffic control system personnel, these shortcomings could justify judicial invalidation of the result in particular cases.

## G. Split Enforcement Authority is Inefficient, Engenders more Disputes in the Long Run, and can Subvert the Public Interest

There are major risks to acceding to the political concerns by separating the adjudication function. The risks are long term in nature and broader than the particular interests and agencies involved in this particular controversy. The problem is that political forces almost always mobilize in favor of splintering administrative functions. Interest groups potentially affected by enforcement are likely to perceive that independent watchdogs of one kind or another are necessary to ensure that the interests get their due from the program agencies.

Such splintering has three undesirable long-run affects. First, it engenders more interagency disputes that must be resolved by some other institution, presumably the courts, the Congress, or the President. Second, it formalizes matters that many times should be left to an informal problem-solving approach. Administrative law judges or other adjudicators gradually become opposed to the kind of informal contact necessary to work things out rather than aggressively litigating them to a conclusion.

While the allocation of prosecutorial and adjudicatory responsibility to different agencies for certificate actions has not produced great interagency conflict, the experience of other split enforcement arrangements legitimately raises concerns about the split enforcement model in the aviation context. The OSHA/OSHRC arrangement is the oldest split enforcement model and their interagency disputes have reached the Supreme Court in two different and important contexts, the context of judicial deference addressed in the *Martin v.*

*OSHRC* case,[225] and the unwillingness of OSHRC to permit OSHA to withdraw cases, addressed in the *Cuyahoga Railroad* case.

Third, the beneficiaries of efficient enforcement, the general public, do not mobilize to protect their interests as effectively as pilots and airlines. The political calculus is more likely to undercut safety by hamstringing enforcement than to achieve a neutral balance between efficiency and fairness.

Thus, it is appropriate to be cautious in jumping to the conclusion that because the affected parties want maximum separation of functions it should be done.

## VIII. Unifying Civil Penalty Adjudication and Certificate Action Adjudication

The controversy over civil penalty adjudication is not simply a matter of choosing between the unitary and split enforcement model. It is complicated by the fact that both models currently are applied to aviation safety enforcement. The split enforcement model is the status quo for certificate actions, while the unitary model is the status quo for the civil penalty demonstration program. Pure adherence to the split enforcement model necessitates transferring civil penalty adjudication authority to the NTSB. Pure adherence to the unitary enforcement model necessitates transferring certificate-action adjudication authority from the NTSB to the FAA. Maintenance of the status quo, an entirely likely outcome once political factors are taken into account, splits the two types of enforcement cases between two different adjudicatory agencies.

Certificate actions generally have more adverse consequences for the certificate holder than civil penalties. An airline whose certificate is suspended or revoked goes out of business. A pilot or mechanic whose certificate is suspended or revoked loses his or her livelihood. Otherwise, however, there is no principled difference between the two kinds of enforcement cases. The same kind of evidence is involved. The same kinds of violations are involved. The same kind of regulatory interpretation is involved. The same arguments about allocating responsibility between pilots, airlines, airport operators, mechanics, and air traffic control personnel exist in both types of cases.

There is no good reason for separating the two kinds of enforcement cases except maintenance of the status quo, political compromise, and the desire of both agencies to have some responsibility for enforcement adjudication.

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[225] The NTSB general counsel told the Conference that NTSB can readily accept the guidance as to deference offered by Martin v. OSHRC and that doing so would not require a noticeable departure from present practice. Supplementary statement by Daniel D. Campbell at 16-17.

There are a number of problems associated with separating the two types of cases, chief among which is the possibility of forum shopping, discussed in §VI(H) and the difficulty in giving ALJs hearing certificate cases the authority to mitigate penalties into civil penalties.

From a purely theoretical standpoint, without regard to political feasibility, any rationalization of aviation enforcement responsibility should ensure that certificate actions and civil penalty actions are adjudicated by the same agency.

# IX. Evaluation of Arguments

In Recommendation 90-1, the Conference articulated the criteria for placement of responsibility for civil penalty adjudication as follows:

> "Such a determination should respond to interests of administrative simplicity and efficiency, fairness and the appearance of fairness, and accountability for aviation safety."[226]

## A. Application of Formality, Efficiency, and Participation Goals

Recent scholarship and caselaw emphasize three major goals for administrative procedure: formality,[227] efficiency,[228] and participation.[229]

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[226] Recommendation 90-1, "Civil Money Penalties for Federal Aviation Violations," 55 Fed. Reg. 34209 (Aug. 22, 1990) (to be codified at 1 CFR §305.90-1).

[227] Formality, aimed at facilitating judicial reviewability, is the major contribution of the New Deal formalist school. Judicial reviewability is the major artifact of the delegation doctrine and ensures separation of powers. Delegation of legislative authority is constitutional as long as the Congress gives standards to guide exercise of the delegated authority that can be applied as meaningful constraints by the courts. Judicial reviewability ensures maintenance of separation of powers requirements because it reserves to the courts the final decision on matters of law. *See generally* Crowell v. Benson 285 U.S. 22 (1932) (no separation of powers problem in authorizing administrative official to engage in adjudicatory factfinding subject to judicial review); Thomas v. Union Carbide 105 S.Ct. 3325 (1985) (no violation of separation of powers when statute mandated arbitration of disputes over use of proprietary test data in conjunction with pesticide registration).

[228] Efficiency is the Supreme Court's major contribution in Mathews v. Eldridge, 424 U.S. 319, 347-349 (1976); Dixon v. Love, 431 U.S. 105, 114 (1977) (administrative effiency and public interest in safe drivers permit suspending drivers license without prior hearing, citing *Mathews*); Nixon v. Administrator of General Services, 433 U.S. 425, 529 n.23 (1977) (Burger, C. J. dissenting) (*Mathews* goal of administrative efficiency is not the only consideration);

Adjudication requirements are determined largely by efficiency considerations, although the participation goal also is an important justification.[230] Efficiency includes two subgoals: accuracy in factfinding,[231] and cost-effective resource allocation.[232] The *Mathews v. Eldridge* formula evaluates adjudicatory entitlements by the marginal improvement in factfinding accuracy resulting from each additional procedural ingredient, and weighs this against the cost in agency resources of adding the step, taking into account the magnitude of the individual deprivation resulting from an error in the decisional process.

Critics of this model, which emphasizes formality and efficiency, urge giving greater emphasis to participation. In their view, participation does more than facilitate judicial control.[233] Critical legal studies emphasize a particular aspect of the participation goal: human dignity.[234] While there are dissenters

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Wilkerson v. Sullivan, 904 F.2d 826, 851 (3d Cir. 1990) (citing *Mathews* in support of observation that certain number of errors must be tolerated in large and complex system of claims adjudication).

[229] Participation has received increased emphasis through broadened standing, increased use and scrutiny of notice-and-comment rulemaking, and scholarly emphasis on the dignity value in due process.

[230] Goldberg v. Kelly, 397 U.S. 254 (1970) (procedures for contesting welfare termination violated procedural due process). Although Goldberg involved Constitutional due process scrutiny of a welfare rights case, more broadly it stands for the need for certain minimal procedures in adjudication. The detailed adjudication requirements under the Administrative Procedure Act (APA) reflect constitutional due process concepts. *Compare* Friendly, *Some Kind of Hearing*, 123 U. Pa. L. Rev. 1267 (1975) (constitutional procedural process) *with* 5 U.S.C. §§554-557 (1988) (statutory adjudication procedures).

[231] Accuracy in factfinding is essentially the same goal as rationality.

[232] *But see* Verkuil, *The Emerging Concept of Administrative Procedure*, 78 Colum. L. Rev. 258, 280 (1978) (emerging judicial support for a spectrum of procedural alternatives to serve values of fairness, efficiency, and satisfaction). Professor Verkuil's efficiency value considers only deciding cases cheaply and quickly. *Id*. at 280. His satisfaction value is close to the dignity value considered in the text. *Id*. at 280. His fairness value apparently takes into account accuracy. *But see id*. at 284 (quoting Frankfurter as endorsing fairness and satisfaction values, "feeling...that justice has been done").

[233] Mashaw, 6 J. L. Econ. & Org. at 286; Stewart, *The Reformation of American Administrative Law*, 88 Harv. L. Rev. 1667 (1975) (interest representation model). *See also* Frug, *The Ideology of Bureaucracy in American Law*, 97 Harv. L. Rev. 1276, 1297-1355 (criticizing formalist (delegation), expertise, and judicial review models).

[234] Critical legal studies attacks all conventional models on the grounds that they are mechanisms for deception. By legitimating bureaucratic control, they frustrate broad reformation of society. Frug, 97 Harv. L. Rev. at 1379-81. The "crits" argue that any effort to develop models of administrative law is futile. Frug, 97 Harv. L. Rev. at 1381.

from those emphasizing the dignitary value,[235] advancement of dignitary goals is a concern both of political science pluralist models and the critical legal studies movement.[236]

There is wide recognition of a dignity basis for due process, as well as the accuracy basis recognized in *Mathews v. Eldridge.*[237] One of the most cited formulations of a dignity basis is Mashaw's,[238] and one of the most quotable is Tribe's:

> Among the formal procedural safeguards ordinarily held to be required by due process, perhaps the two most striking--the right to be heard and the right to hear why--are ultimately more understandable as inherent in decent treatment than as optimally designed to minimize mistakes. When God asked Adam if he had eaten of the tree of life, the Midrash explains, the point of the exchange was less to minimize the

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[235] Magat & Schroeder, *Administrative Process Reform in a Discretional Age: The Role of Social Consequences*, 1984 Duke L. J. 301, 317-18 n.64 & n.65 (1984).

[236] *See* Mashaw, *Administrative Due Process: The Search for a Dignitary Theory*, 61 BUL Rev. 885 (1981) (dignitary approach has merit but should place only modest additional demands on procedures necessary to assure rationality in efficiency context).

[237] *See* Lister v. Hoover, 706 F.2d 796, 801 (7th Cir. 1983) (due process did not require written reasons for denial of request for in-state tuition) (Swygert, J. dissenting) (Constitution recognizes higher values than speed and efficiency, citing Summers, 60 Cornell L. Rev. 1 (1974), Morgan, *The Constitutional Right to Know Why*, 17 Harv. C.R.-C.L. L. Rev. 297 (1982)); R. Cover, W. Fiss, J. Resnik, Procedure 126-127 (1988) (explaining dignity basis for procedure, but acknowledging that limits of procedural entitlements cannot be defined only in terms of what is satisfactory to claimant).

[238] Mashaw, *The Supreme Court's Due Process Calculus for Administrative Adjudication in Mathews v. Eldridge: Three Factors in Search of a Theory of Value*, 44 U. Chi. L. Rev. 28, 50, (1976). Mashaw explains the limits of the *Mathews v. Eldridge* utilitarian approach, and explains how consideration of other values, including individual dignity, equality, and tradition would improve the acceptability of limits on procedural entitlements. He acknowledges that the additional values would not have led to a different outcome in *Eldridge* and that techniques for limiting procedural entitlements under the dignity value have been unsatisfactory. 44 U. Chi. L. Rev. at 58. *See also* Saphire, *Specifying Due Process Values: Toward a More Responsive Approach to Procedural Protection*, 127 U. Pa. L. Rev. 111, 117, 163 (1978) (importance of personal, and oral participation to serve dignitary value of procedure, not given enough weight by utilitarian approach); LaTour, *Determinants of Participant and Observer Satisfaction with Adversary and Inquisitorial Modes of Adjudication*, 36 J. PERSONALITY & SOC. PSYCHOLOGY 153 (1978) (empirical showing that adversarial procedures are favored because they give disputants more 'process control')[CHECK]; Michelman, *Formal and Associational Aims in Procedural Due Process*, XVIII NOMOS 126, 127-28 (1977) (due process vindicates values of 'participation.'; noting psychological importance of 'participatory opportunity,'

> risk of divine error than to afford Adam a moment to regain his composure.[239]

Fairness--something close to the dignity value--seems to be at the heart of the arguments in favor of NTSB authority. Efficiency is at the heart of the arguments in favor of FAA authority.[240] Perceived fairness is important in law. Legitimacy underlies all political authority in a democratic political system. An agency perceived as being consistently unfair is not likely to retain its legitimacy for long. It may be the FAA has lived too long under a system in which the agency could take a single-minded prosecutorial view of things. It may simply be too difficult to change agency attitudes to an environment in which the FAA administrator is sometimes an enforcement policy officer and sometimes a neutral adjudicator.

Moreover, it may be that efforts to resolve underlying problems with respect to the safety program would be enhanced by removing adjudicatory authority because the administrator would be free to talk to interested groups about enforcement policy and prosecutorial conduct.

The ultimate test for governmental decision-making arrangements in a democratic society is legitimacy. If an arrangement is accepted by all of the affected interests, it should not matter much whether it satisfies *a priori* models of decision-making efficiency or fairness. Conversely, if a decision-making process is not accepted by significant affected interests theoretical support matters little.

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regardless of result); Summers, *Evaluating and Improving Legal Processes--A Plea for 'Process Values,'* 60 Cornell L. Rev.1, 20-21 (1974).

[239] L. Tribe, American Constitutional Law §10-15 at 744 (2d ed. 1988). Michelman says it this way:

> (T)he individual may have various reasons for wanting an opportunity to discuss the decision with the agent. Some pertain to external consequences: the individual might succeed in persuading the agent away from the harmful action. But again a participatory opportunity might also be psychologically important to the individual: to have played a part in, to have made one's apt contribution to, decisions which are about oneself may be counted important even if the decision, as it turns out, is the most unfavorable one imaginable and one's efforts have not proved influential.

Michelman, *Formal and Associational Aims of Procedural Due Process*, in Due Process, Nomos XVIII 127-28 (J. Pennock & J. Chapman, eds. 1977).

[240] The arguments about the desirability of officials with safety functions needing exposure to enforcement adjudication essentially cancel each other out because both the administrator and the NTSB have safety responsibilities. That leaves the perceived fairness and the other efficiency arguments.

This test of acceptability can be tricky to apply. Properly applied, it asks whether all affected interests are satisfied with the process. Clearly, general aviation (and some airline) pilots have not been satisfied in the past with adjudication of civil penalties by the FAA, and significant parts of the airline community also have been dissatisfied. If the interests of these groups alone are relevant, the legitimacy criterion would strongly militate in favor of placing the adjudication responsibility with the NTSB. There are, however, other interests. The general public has multiple interests. The general public is interested in a safe aviation system. It also is interested in an efficient, modern, convenient system. The Secretary of Transportation and the Administrator of the FAA are charged with furthering these interests. Any arrangement for adjudicating civil penalties that demonstrably undermines these interests is questionable.

The most inflammatory issue for the airlines is the one with the greatest passenger safety implications. Civil penalties are imposed in airport security cases to encourage airlines and airports to have the closest thing possible to a zero defects weapons and explosives screening process. Any intelligent program in pursuit of this objective necessarily uses test objects; it should not wait for an actual weapon or bomb to be carried aboard an aircraft and possibly used. Moreover, any rational programs should not accept a 5 percent error rate. According to this view, imposition of relatively modest monetary penalties for each instance in which a shortfall in airport security is detected is an appropriate economic incentive to improve airport security. The objection of the airlines to civil penalty procedures and structural arrangements really is an objection to the underlying premises of enforcement policy. No relocation of administrative appeals authority to the NTSB can respond to this fundamental objection.

Moreover, it is far from clear that a relatively episodic reaction to changes in enforcement policy by those subject to enforcement ought to preempt other considerations. Otherwise, if deference to such reactions are carried to their extreme, any enforcement program can be limited by the wrong-doers at which it is aimed. This is not to say that heavy-handed, overly formal, enforcement is the best way to pursue the safety objectives of the Federal Aviation Act. The reality is that enforcement agencies are at some level at the mercy of their victims. An agency that is insensitive to the feelings of large segments of respected members of the public risks having its authority curtailed.

In evaluating the arguments favoring placement of adjudicatory authority in the NTSB, one should not forget that multiple guarantees of fairness in the enforcement process exist without creating an independent administrative watchdog. Most fundamental and most independent, is judicial review of agency action. Judicial review is available regardless of how the administrative adjudication function is structured. Second, is the requirement under the APA that the matters be heard by administrative law judges whose independence from the prosecuting agency is assured by other provisions of the APA. Third, is the APA §554(d) requirement that prosecutorial and judging functions be separated. The principal difficulty with the NTSB alternative is that it is not directly responsive to the underlying problems of enforcement policy and noncompliance with procedural rules.

A completely neat division of responsibility between the FAA and the NTSB is unlikely. Separating the accident investigation function from the rulemaking, prosecutorial, and airspace administration functions is well established. There is little argument in favor of abandoning this much of the split enforcement model as it has been reflected in aviation regulation for several decades.

One can, of course, make a principled distinction between adjudication and investigation and factfinding. The NTSB's accident investigation function does not culminate in an adjudicatory decision. One could conclude that the NTSB should not be involved in any kind of adjudication. Adjudication arguably requires different skills from those required of an effective factfinder and mobilizer of public scrutiny. Also, one could argue that NTSB adjudication is a distraction because it diverts resources that otherwise should be devoted to accident investigation. The Congress should not load the NTSB with so much adjudicatory responsibility that its accident investigation function suffers. This could happen at three levels. First, adjudication responsibility could divert staff resources. Second, adjudication responsibility could divert the attention of the board itself. Third, over the long run, constituency concern with adjudication could influence the selection of board members to the detriment of member orientation toward the accident investigation function.

The opposing argument begins with a proposition that accident investigation and factfinding, like adjudication, should be separated institutionally from the responsibility for running the airspace system. Under this view, the point is not so much separating the judging from the prosecutorial function as it is separating the judging from the administration or operational function. This conceptual approach says that all adjudication ought to placed at the NTSB rather than the FAA. But it also says more than that. If adjudication should not be commingled with administration and operation, neither should prosecution. Leaving the prosecution function at the FAA and placing the judging function elsewhere is not a completely principled resolution. Nevertheless, commingling of the prosecution and operational functions at worst leads to prosecutorial protection of the operational authority and to a more vigorous prosecution of others. Separate NTSB investigatory and factfinding functions ensure that shortcomings in the operational function will come to light, and that non-FAA personnel subject to prosecution will be protected by NTSB oversight, even though the FAA adjudicates.

There are some other realities, besides political ones, that temper the search for a principled solution. Even if adjudication responsibility is placed with the FAA, it is virtually certain to be exercised in fact by administrative law judges. This forces a considerable institutional separation of the initial judging function, tempering the theoretical advantages of giving it to the institution with the broadest responsibility for aviation policy. It is important to keep in mind, therefore, that the argument is only about the placement of authority to decide the handful of cases in which the ALJ decision is overturned, rather than the vast majority of cases.

Under any proposed system, there are multiple protections against prosecutorial unfairness or inaccuracy. The first level of protection is a hearing before an ALJ, who must make a decision based on the record, and who is assured of independence from the FAA by the APA. Indeed, the acting chief administrative law judge of the Department of Transportation noted in his testimony in the June 19, 1991 the Conference hearing that, "the administrative law judge's 'impartiality serves as the ultimate guarantee of a fair and meaningful proceeding in our constitutional regime'."[241] Second is appellate review of the ALJ decision by either the FAA administrator or the NTSB. Third, is judicial review of the final result. Irrationality or bias can be corrected at the judicial review stage.

On balance, this is a very close case, as the Conference recognized in 1990 and as the Congress recognized in mandating further study. Before reaching a conclusion as to the placement of civil penalty adjudication responsibility, leaving other things the same and accepting the arguments as presented, it is appropriate first to identify other organizational alternatives and to articulate specific conclusions.

## B. The Role of FAA Policy Decisions or Interpretations of Law in Individual Case Adjudications

Several aspects of the relationship between different FAA functions and between the FAA and the NTSB raise the question of how much force a preexisting FAA rule should have in an adjudication. The term "rule" for the limited purpose of this discussion includes not only formal rules promulgated under the APA but also less formal policy statements, instructions, and guidance to FAA employees and interpretations developed for a particular case. The problem arises when an ALJ or the NTSB is asked to defer to the FAA on the appropriateness of sanctions for particular conduct. It arises in the context of the FAA/airline industry dispute over the legitimacy of the test object program. It arises in discovery disputes over assertions of privilege. Several things are reasonably clear about the relationship between preexisting rules and individual case adjudication.

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[241] Statement of Ronnie A. Yoder (quoting Marshall v. Jerricho, 446 U.S. 238, 250 (1980) (apparently referring to judges in general) ).

It is not clear how transferring adjudication authority to the NTSB would improve the ability of an interested party to challenge a rule applied in an adjudication. Indeed, if the FAA retains authority to interpret its own rules, challenging a rule would be even more difficult in an NTSB adjudication than in an FAA adjudication.

This is an efficiency argument in favor of retaining adjudication authority at the FAA.

Any adjudicator--the administrator or the administrator's delegate in hearing an adjudicatory appeal, an ALJ, or the NTSB--is obligated to give effect to a rule promulgated under §553 of the Administrative Procedure Act.

Parties to an adjudication are entitled to challenge the validity of a rule applied in an adjudication on the grounds set forth in §706 of the administrative procedure act.[242] Thus, if a party can show that the rule applied in a particular case is arbitrary and capricious, in excess of agency authority or not established according to procedures required by law, the rule is entitled to no effect in the adjudication even though it formally exists.

Under existing law, the FAA, like other agencies, may establish rules in the course of adjudicating individual cases as well as through notice-and-comment rulemaking.[243] When this is done, however, the FAA must provide support for the rule in the case in which it is developed and that support must satisfy the arbitrary and capricious test of 5 USC §706(2)(A) and be within FAA authority. A rule thus established may be applied in subsequent cases, in which event the support marshaled for the rule in the first case supports its validity in the second case.[244]

However, positions taken by FAA advocates are not entitled to deference simply because the advocate expressed them; they are like any other party position.

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[242] 5 U.S.C. §706 (1988).

[243] See SEC v. Chenery Corp., 318 U.S. 80 (1943); NLRB v. Wyman-Gordon Co., 394 U.S. 759 (1969); NLRB v. Bell Aerospace Co., 416 U.S. 267 (1974); American Hospital Association.

[244] See generally NLRB v. Wyman-Gordon Co., 394 U.S. 759 (1969); NLRB v. Bell Aerospace Co., 416 U.S. 267 (1974).

Moreover, propositions articulated in policy statements, press releases, or guidance to FAA employees are not entitled to any particular effect, but they may be used as rules in a particular case as long as they are supported in the case in which they are first applied.

There is no legal reason that procedural rules for adjudications could not reserve the power to determine challenges to a rule to the administrator or someone else other than an ALJ.

# X. Alternatives

A number of other alternatives can be considered, besides simply placing adjudicatory responsibility for civil penalties in either the FAA or the NTSB.

## A. Bifurcate Hearings and Appeals

DOT ALJs could hold hearings and the NTSB could handle appeals. The problem with this arrangement is that it really does not resolve anything except the resource issue with respect to NTSB authority. The real arguments relate to the exercise of administrative appellate authority. So this approach accepts the arguments in favor of NTSB authority and rejects those favoring FAA authority.

## B. Bifurcate Pilot and Airline Cases

The Department of Transportation could retain responsibility for all civil penalties except those frequently associated with certificate actions as alternative sanctions. Under this approach, airline violations would remain the province of the FAA, with or without changes in FAA procedures and the structure for allocating responsibility.  To prevent forum shopping and to make it easier for ALJs to mitigate penalties across the full spectrum, pilot violations all would be the responsibility of the NTSB. While it is somewhat artificial to separate different types of civil penalties depending on the identity of the violator, this is a lesser evil than splitting civil penalties from certificate actions with the associated problems of forum shopping and the inability to mitigate penalties.

## C. Reform Existing Arrangements

FAA and NTSB procedures for civil penalty and certificate action adjudication could be reformed, especially eliminating differences in limitation periods and other differences that may encourage forum shopping. Under this option, the responsibility for adjudication would remain bifurcated, with the FAA adjudicating civil penalties and the NTSB adjudicating certificate actions.

### 1. Administrative Appeals Board within the Office of Secretary of Transportation

Administrative appellate authority could be removed from the FAA Administrator and delegated to a new administrative appeals board within the Office of the Secretary of Transportation, modeled on the recommended changes in the social security appeals council within the Department of Health and Human Services.[245] Appeals from ALJ decisions would go directly to this appeals council or would go to the appeals council after an administrator decision.

### 2. Administrative Appeals Board within the Office of the Administrator

An administrative appeals board could be established within the Office of the FAA Administrator, with authority similar to that exercised by the designated career official under the DOT route authority procedural regulations. The problem with this arrangement is that it removes the overall policy context for deciding civil penalty appeals, which is one of the major arguments in favor of FAA adjudicatory authority.

### 3. Further Separation of Functions

Further steps could be taken to separate functions within the FAA. For example, a completely separate appellate counsel could be established, independent of the FAA chief counsel, to advise the administrator on civil penalty appeals. This would follow to a greater extent the CAB model, in which the Bureau of Enforcement was separated from the general counsel. Alternatively, the prosecutorial function could be removed from the chief counsel and delegated to a new enforcement counsel. Of the two, it may be better to set up a new enforcement counsel responsibility to preserve the chief counsel's policy-making role. On the other hand, making prosecutorial responsibility more independent of policy direction reduces the likelihood of compromise, settlement, and a problem-solving orientation at the early stages of enforcement proceedings.

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[245] See generally Conference Recommendation 83-3, 1 CFR §305.83-3 (1991) (recommending different structures for administrative appellate review of ALJ decisions depending on nature of caseload); id. Recommendation paragraphs 3(a), (b) (recommending individual decisionmakers delegated authority from statutory authority when caseloads are large and a single skill or discipline, and descriptive facts are involved; recommending review boards when multiple skills, intermediate caseloads, or complex facts are involved); Conference Recommendation 87-7, codified at 1 CFR §87-7 (1991) (recommending further improvements in social security appeals council).

### 4. Changes in Discovery Procedure

Specific changes can be made in the FAA's discovery procedure as appropriate to alleviate legitimate concerns about burdens and discovery against individual pilots or other persons unable to bear the cost of discovery.[246]

### 5. Changes in Limitation Periods

The limitation period for certificate actions or for civil penalty actions or both could be changed to remove any incentives for forum shopping.

### 6. Authority to Adjust Sanctions

One of the inflexibilities in the present system is that enforcement actions begun as certificate actions cannot be mitigated into civil penalty actions once a hearing is requested. This is undesirable. Moreover, the present regulations limit the authority of an ALJ to change the amount of a civil penalty. The limitations on ALJ authority with respect to civil penalty amounts can be changed by changes in the FAA regulations. Permitting certificate actions to be changed into civil penalty actions probably would necessitate statutory change or interagency agreement between NTSB and the FAA (unless certificate action adjudicatory authority is transferred to the FAA).

### 7. Tighten Procedural Requirements and Compliance

Many of the airline industry concerns have to do with the perceived failure of FAA advocates to comply with FAA procedural rules. There are a number of ways to address this problem.

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[246] Chief Administrative Law Judge John J. Mathias notes that ALJs have granted discovery against the FAA, and in at least one case have barred the FAA from presenting evidence as a result of a failure to follow pretrial orders to provide certain information. Letter from John J. Mathias to Henry H. Perritt, Jr., Sept. 19, 1991, commenting on draft report, citing Delta Air Lines, Inc., Dkt. CP90WP0099, Tr. of Hearing, Mar. 4, 1991, pp. 24-26, 36-37.

The institutional responsibility for writing procedural rules and for enforcing them, through sanctions if necessary, could be removed from the FAA and placed elsewhere. For example, the office of the Secretary could be responsible for adopting procedural rules and sanctions for noncompliance with procedural rules could be the responsibility of the office of the Secretary, conceivably including personnel sanctions as well as sanctions aimed at the presentation of a particular case.

Procedural deficiencies could be grounds for overturning any civil penalty on judicial review. The airline industry is concerned that judicial deference to FAA interpretation of its own rules would make this a meaningless possibility, and in any event a costly one.

The rules could be rewritten to remove ambiguities and strengthen sanctions for failure to make discovery. The airline industry has given up hope on this option because of its belief that the rule changes won through a combination of litigation and the Conference recommendations in 1990 have proven ineffective because the FAA will not comply with them.

## 8. Provide for Special Review of Rule Challenges

As §IX(B) explains, persons subject to adverse agency action should not be foreclosed from adjudicating certain issues by the application of preexisting rules that have never been the subject of public scrutiny or adversarial inquiry. The Administrative Conference is working on a comprehensive recommendation on what is entitled to the status of a rule in an adjudication. Pending completion and review of that Administrative Conference effort, it is appropriate to consider procedural alternatives that could ensure an adequate opportunity for affected parties to challenge standards or policies that are functionally equivalent to rules without distorting the allocation of responsibility between policy officials and administrative law judges and without forcing the FAA to adopt policies only through §553 notice-and-comment rulemaking, a requirement not imposed on any other agency. The following proposed procedural rule would do that. There is no legal impediment to allocating responsibility in this way. The formal adjudication requirements of the APA only require that an administrative law judge or the agency preside over the taking of evidence.[247] Challenges to rules do not typically involve evidentiary controversies. If evidence is required to resolve a challenge to a rule, that evidence should be taken before an ALJ. But there is no requirement that an ALJ determine the validity of rules. It is preferable for policy officials to determine rule challenges. Otherwise, rulemaking authority that formally is placed in policy components of an agency actually are exercised by persons insulated from policy control.

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[247] 5 U.S.C. §556(d) (1988).

There is a possibility that the proposed procedure could be abused. Respondents could make rule challenges in every case for purposes of delay or to increase costs to the agency. If this occurs, consideration can be given to affording an opportunity for the rule challenge only at the end of the factual part of a hearing, in other words eliminating interlocutory rule view and providing for it only after an initial decision has been entered by the ALJ, under 14 CFR §13.233.

The following changes should be made in the FAA procedural regulations, "Subpart G - Rules of Practice in FAA Civil Penalty Actions:" Boldfaced type indicates new language.

### §13.202 DEFINITIONS

***Senior Reviewing Official* means a career official within the FAA, selected by the Secretary of Transportation acting in the capacity of the decisionmaker on interlocutory appeals to a rule challenge. If the parties agree on a neutral meeting the requirements of 5 USC §583 (Administrative Dispute Resolution Act), that person shall be the senior reviewing official.**

***Rule challenge* means a prehearing motion by a respondent to challenge the procedures employed by the FAA in developing a rule or regulation.**

§13.218 MOTIONS

(1) *Rulings on Motions.*

(2) *Prehearing Motions.* The administrative law judge shall resolve all pending motions, **except rule challenges, not later than 7 days before the hearing. Rule challenges are to be resolved pursuant to §13.219(b).** If the administrative law judge issues a ruling or an order verbally, the administrative law judge shall serve a written copy of the ruling or order, within 3 days, on each party. In all other cases, the administrative law judge shall issue rulings and orders in writing and shall serve a copy of the ruling or order on each party.

§13.219 INTERLOCUTORY APPEALS.

(3) *General.* Unless otherwise provided in this subpart, a party may not appeal a ruling or decision of the administrative law judge to the FAA decisionmaker until the initial decision has been entered on the record. A decision or order of the FAA decisionmaker or senior reviewing official on the interlocutory appeal does not constitute a final order of the Administrator for the purposes of judicial appellate review under section 1006 of the Federal Aviation Act of 1958, as amended.

**(4) *Interlocutory appeal for rule challenge.* If a party files a rule challenge with the administrative law judge, the motion is to be considered an interlocutory appeal. When the appeal is filed, the administrative law judge is to stay the proceeding and submit the challenge to the senior reviewing official. The proceedings are stayed until the senior reviewing official issues a decision on the interlocutory appeal.**

(5) *Interlocutory appeal for cause.*

(6) *Interlocutory appeal of right.*

(7) *Procedure.*

(8) *Procedure for interlocutory appeal.*

(9) ***Procedure for rule challenge.* A party shall file a notice of rule challenge, with supporting documents, with the senior reviewing official, and shall serve a copy of the notice and supporting documents on each party not later than three (3) days after a rule challenge is filed. A party may file a reply brief not later than 10 days after service of the appeal brief. The reply brief shall be filed with the senior review official and a copy served on each party, . The senior reviewing official shall render a decision on the rule challenge based on an interpretation and application of relevant statutory and regulatory requirements, legal precedents, and policy considerations. The decision of the senior reviewing official is to be applied by the administrative law judge as the controlling**

> **rule of law in the hearing. If evidence is required to resolve a rule challenge, the senior reviewing official shall remand the case to an ALJ for the limited purpose of taking evidence and reporting findings of fact, within the order of reference to the ALJ.**

### 9. Sunset/Periodic Oversight

The Congress could allow a period of 5 years to pass with the adjudication responsibility split between the FAA and the NTSB along present lines. Eventually it could consolidate adjudication responsibility for both certificate actions and civil penalties, the agency depending on the 5-year experience.

## D. Consensual Problem Solving

This controversy is well-suited for resolution through a mediation and problem-solving process.[248] Ultimately, the concerns of the affected pilot and airline communities must be addressed through better relations between those communities and the FAA. The real unfairness arises, not from the placement of responsibility for deciding a relatively minuscule proportion of the cases that are appealed from the initial ALJ decision; it arises from inappropriate or rigid enforcement action. Enforcement responsibility under any realistic scenario will remain with the FAA. The FAA wants to keep civil penalty adjudication responsibility. To keep it, it needs acquiescence by the politically powerful airline and pilot communities. There are a number of possibilities for changing the structure and the procedures for FAA adjudication that could ameliorate the concerns of these communities with respect to FAA responsibility and reduce the force of the arguments in favor of relocating the responsibility to the NTSB.

Accordingly, the best way to work these things out is through a specially constructed mediation process involving the administrator and the chief counsel of the FAA and a limited number of representatives of the airline and pilot communities. This process could result in specific regulatory language to be issued as a proposed rulemaking by the FAA, or specific statutory language to be proposed to the Congress by the FAA and the interest groups jointly. Consultations begun by the author of this report showed promise. All affected interests expressed willingness to consider a variety of alternatives and agreed that a more cooperative relationship between the FAA and its regulatees is desirable. The principal problem the author experienced in the consultation process was that some parts of the airline industry was worried about undermining its position that the civil penalty program must be scrapped, and therefore would not help develop other alternatives. There is nothing impermissible or unseemly in this. These interests like everyone else are entitled to develop their own political strategies.

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[248] Administrative Conference Recommendation 85-5, 1 CFR §305.85-5 (1989) (encouraging agencies to use negotiated rulemaking). See Perritt, *Negotiated Rulemaking before Federal Agencies: Evaluation of Recommendations by the Administrative Conference of the United States*, 74 Geo.L.J. 1625 (1987).

It may be necessary to provide for a measure of confidentiality in the discussions, recognizing that adequate opportunity for public input occurs during notice-and-comment rulemaking and through the legislative process and the Conference open proceedings on formulation of recommendations.

## XI. Conclusions

The Congress already has decided to divide responsibility for aviation safety between the FAA and the NTSB, and the division of responsibility has worked reasonably well.

The division of responsibility between the NTSB and the FAA envisions the FAA in a decision-making capacity and the NTSB in an evaluation and recommendation formulation capacity. This division of responsibility in the context of civil penalties can support assigning civil penalty adjudication responsibility to either agency.

The chief counsel of the FAA controls both the prosecution function and the formulation of advice to the administrator on the adjudication function. The exercise of both responsibilities has been separated under the FAA regulations.

Assuring fairness and promotion of safety should not depend on the attitudes of individual incumbents of key positions in either the FAA or the NTSB.

The existing arrangement potentially encourages forum shopping, although empirical evidence of such forum shopping is lacking.

It is useful for the administrator of the FAA to be exposed personally to enforcement cases.

It is useful for the NTSB to be exposed to enforcement cases.

There is no evidence of unfairness or mishandling of cases under the present system, resulting from commingling of prosecutorial and judging functions.

There is a possibility that the FAA's increased use of its emergency authority has increased the numbers of NTSB appeals, thereby distorting the work load and back log statistics.

Conformity between the procedures of two different agencies with adjudication responsibility is desirable.

Completion of administrative procedures takes too long in both civil penalty and certificate cases.[249]

Use of alternative dispute resolution techniques, including mediation, arbitration, and settlement judges is desirable.[250] The FAA currently offers an informal Conference in every civil penalty case.

It may be desirable to let the factfinder decide the penalty, so for example, an airline pilot could get a large fine instead of a 60-day suspension, which costs her her job.

Parties to enforcement proceedings should have an opportunity to challenge outcome determinative rules, policies, or standards applied in the adjudication, but the ALJ need not be the person who decides such challenges, and the FAA is not obligated to make all rules through notice-and-comment rulemaking.

The FAA should have the right to appeal from an NTSB decision, if the NTSB has decision-making authority. Pilot representatives argued at the June 19, 1991 hearing that any such authority must be circumscribed to avoid inappropriate imposition of costs on pilots by use of the FAA review petition authority. Subsequently, the NTSB general counsel suggested three possible ways for circumscribing such authority: (1) limiting FAA appeals to matters involving interpretation of FAA regulations or policies, (2) limiting appeals to situations where the administrator believes that an NTSB interpretation will necessarily and irremedially impede prospective application of FAA policy, or (3) giving control over FAA appeals to the Department of Justice.[251]

Joint problem solving, involving the pilot community and the FAA in a spirit of reasonable harmony and trust is desirable.

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[249] *Accord* supplementary statement of Daniel D. Campbell at 8 n. 11 (noting elapse of time from potential violation dated May 1988 to final appellate decision in February 1991 in FAA civil penalty case and elapse of time from potential violation date of September 1987 and final appellate decision of September 1990 in NTSB suspension case).

[250] See Conference Recommendation 86-3, codified at 1 CFR §305.86-3 (use of alternative dispute resolution in individual case handling); Conference Recommendation 88-5, codified at 1 CFR §305.88-5 (use of settlement judges).

[251] Supplementary statement of Daniel D. Campbell at 18-19.

# XII. Recommendation

## A. Explanation

The best resolution of the controversies associated with civil penalty adjudication authority would be a consensual one, satisfying the legitimate concerns of the FAA and the affected interests. Recommendation 1 is intended to operate only in the absence of such a consensual resolution. This recommendation avoids splitting civil penalty and certificate authority, thus eliminating the potential for forum shopping. It eliminates potential conflicts of interest as to that class of cases in which conflict is most likely between FAA employees with operational responsibility and persons subject to civil penalty authority. The FAA is nearly unique in its exercise of operational responsibility, which makes it a co-actor with persons or entities subject to its regulatory jurisdiction. This special characteristic provides plausible justification for treating the FAA differently from other agencies adhering to the unitary enforcement model. Removal of pilot cases from the FAA conflicts the least with comprehensive exercise of FAA safety policy authority because of the individual character of most violations involved in these cases, compared with a more systemic problem frequently manifested in airline, airport security, and hazardous materials cases. The perceptions problem should be largely addressed by this change inasmuch as pilot respondents are the ones least sophisticated about allocation of agency responsibility, and least aware of the legitimacy of the unitary enforcement model in administrative procedure.

Conversely, retention of FAA civil penalty authority for nonpilot cases presents less potential for conflict between respondent interests and the FAA's air traffic control responsibility, and there is greater likelihood that the problems exposed by civil penalty actions are systemic in nature, necessitating some change in FAA oversight of airline aircraft maintenance or airport operator conduct.

The recommendation to transfer certificate authority for airlines from the NTSB to the FAA would affect relatively few cases because certificate actions are unusual except with respect to pilots, and therefore NTSB authority is exercised infrequently. This transfer is necessary to avoid bifurcating responsibility between the FAA and the NTSB in similar classes of cases.

Recommendation 3 proposes reform of the discovery process along the lines recommended in August 1991 for district courts by the Committee on Rules of Practice and Procedure of the Judicial Conference of the United

States. It contains a specific recommendation for dealing with discovery requests that are resisted on the ground of privileges including the deliberative privilege under *Morgan v. United States*.

Recommendation 4 suggests that the FAA take appropriate steps to ensure that adequate opportunities are available for rule challenges. In doing so, the agency should consider the changes to its procedural regulations discussed in §X(C)(8).

Recommendation 5 encourages greater use of a variety of dispute resolution techniques in individual cases. The growing body of alternative dispute resolution literature supports the view that efficiency gains for everyone are available from flexible means of resolving disputes. New procedures for compromising cases are desirable in this regard. Many civil penalty cases now go to informal settlement conferences, but in many cases the prosecutors decline to consider compromises and monetary penalty amounts, apparently on direction from Washington. Some respondents perceive that informal contact with officials at the inspector level can be used to generate incriminating evidence. Further steps should be taken to explore the utility of settlement judge concepts. In addition, there may be advantages in adopting new technologies for certain aspects of adjudication, along the lines suggested in Recommendation H of the Conference Recommendation 88-10.

Recommendation 6 encourages the FAA and the NTSB to build on the DOT's good record in automating administrative procedures and permitted affected persons to communicate with the agencies electronically.

## B. Recommendation Text

1. The civil penalty program should be made permanent, in accordance with Recommendation 90-1. There is no objectively correct placement of adjudicatory authority over civil penalties. Accordingly, if the FAA and the affected interests agree on an arrangement for exercise of adjudicatory authority, the Conference does not intend these recommendations to represent a barrier to implementation of such an agreement. In the absence of consensus on the subject:

    A. Authority for adjudicating civil penalties against pilots should be transferred from the FAA to the NTSB, with all other civil penalty adjudication authority remaining at the FAA.

    B. The factfinder should be able to decide the penalty as part of a recommended decision, within validly established schedules, standards or guidelines, so for example, an airline pilot could get a large fine instead of a 60-day suspension, which costs her her job.

C. The FAA should have the right to appeal from an NTSB decision.

2. Responsibility for certificate actions not involving pilots should be transferred from the NTSB to the FAA.

3. Discovery rules in civil penalty cases should be changed to provide as follows:

A. Each party shall, without awaiting a discovery request, provide certain information, including (1) the name, and if known, the address and telephone number of each individual likely to have information that bears significantly on any claim or defense, identifying the subjects of the information; and (2) a copy of, or a description by category and location of, all documents, data compilations, and tangible things in the possession, custody or control of the party that are likely to bear significantly on any claim or defense. Unless the ALJ otherwise directs or the parties stipulate with the ALJ's approval, these disclosures shall be made by the agency within 30 days after service of a request for a hearing in response to a final notice of proposed civil penalty, and by a respondent within 30 days after serving its request for a hearing in response to a final notice of proposed civil penalty.

B. Discovery shall be limited by the ALJ if the ALJ determines that the burden or expense of the proposed discovery outweighs its likely benefit.

C. No more than two depositions, nor any deposition longer than 6 hours shall be taken without leave of the ALJ.

D. No more than 15 interrogatories may be served by one party upon another, without leave of the ALJ.

E. When information is withheld from disclosure or discovery on a claim that its is privileged, the claim shall be made expressly and shall be supported by a description of the nature of the documents, communications, or things not produced or disclosed that is sufficient to enable other parties to contest the claim.

F. Controversies over information withheld from discovery on the grounds of privilege shall be subject to interlocutory appeal as a matter of right.

G. The FAA and interested parties should undertake a rule negotiation over these and other aspects of discovery rules for civil penalty adjudications.

4. Before applying a policy made outside notice-and-comment rulemaking, or adopted in an earlier adjudication, the FAA should give affected persons a fair opportunity, either in the adjudication or in a separate proceeding, to challenge the legality or wisdom of the policy and

to suggest alternative policy choices, in a forum that ensures adequate presentation of the affected person's positions and consideration of these positions by persons with authority to take or recommend final action upon them.

5. The primary focus of any changes in the civil penalty program should be on improving trust and developing a problem solving orientation, including the pilot community, the airline community, the FAA and the NTSB. This could occur in a variety of contexts, including the context of a negotiated rule for the procedures for civil penalty adjudication and appeal.

A. Whoever has adjudicatory responsibility for civil penalties and FAA prosecutors should place greater emphasis on alternative dispute resolution in individual cases. The FAA and NTSB, to the extent it retains adjudicatory responsibility, should consider the analysis and conclusions of the September 1990 Conference report on the use of settlement judges and simplified proceedings in agency adjudication, and make greater use of these techniques.

B. For civil penalty adjudication responsibility transferred to the NTSB, the statute should be amended to make it clear that the adjudicating authority has no authority to interfere with informal settlement, or with communications aimed at arriving at such settlements.

C. For civil penalty adjudication responsibility retained by the FAA, the procedural rules should be amended to make it clear that the adjudicating authority has no authority to interfere with informal settlement, or with communications aimed at arriving at such settlements. This can be done by reserving in the agency the authority to discuss settlement.

6. The FAA and the NTSB should consider whether new information technologies can be used to improve the adjudication process, as recommended in the Conference Recommendation 88-10, Paragraph H.

# Appendixes

## A. Statutory Authority for FAA and NTSB

### 1. Certificate Action Authority

49 USC App. §1429. Reinspection or reexamination; amendment, suspension, or revocation of certification

(a) Procedure; notification; hearing; appeal to National Transportation Safety Board; judicial review

The Secretary of Transportation may, from time to time, reinspect any civil aircraft, aircraft engine, propeller, appliance, air navigation facility, or air agency, or may reexamine any civil airman. If, as a result of any such reinspection or reexamination, or if, as a result of any other investigation made by the Secretary of Transportation, he determines that safety in air commerce or air transportation and the public interest requires, the Secretary of Transportation may issue an order amending, modifying, suspending, or revoking, in whole or in part, any type certificate, production certificate, airworthiness certificate, airman certificate, air carrier operating certificate, air navigation facility certificate (including airport operating certificate), or air agency certificate. Prior to amending, modifying, suspending, or revoking any of the foregoing certificates, the Secretary of Transportation shall advise the holder thereof as to any charges or other reasons relied upon by the Secretary of Transportation for his proposed action and, except in cases of emergency, shall provide the holder of such a certificate an opportunity to answer any charges and be heard as to why such certificate should not be amended, modified, suspended, or revoked. Any person whose certificate is affected by such an order of the Secretary of Transportation under this section may appeal the Secretary of Transportation's order to the National Transportation Safety Board and the National Transportation Safety Board may, after notice and hearing, amend, modify, or reverse the Secretary of Transportation's order if it finds that safety in air commerce or air transportation and the public interest do not require affirmation of the Secretary of Transportation's order. In the conduct of its hearings the National Transportation Safety Board shall not be bound by findings of fact of the Secretary of Transportation. The filing of an appeal with the National Transportation Safety Board shall stay the effectiveness of the Secretary of Transportation's order unless the Secretary of Transportation advises the National Transportation Safety Board that an emergency exists and safety in air commerce or air transportation requires the immediate effectiveness of his order, in which event the order shall remain effective and the National Transportation Safety Board shall finally dispose of the appeal within 60 days after being so advised by the Secretary of Transportation.

The person substantially affected by the National Transportation Safety Board's order may obtain judicial review of said order under the provisions of section 1486 of this title, and the Secretary of Transportation shall be made a party to such proceedings.

(b) Violation of certain laws

The Secretary of Transportation, in his discretion, may issue an order amending, modifying, suspending, or revoking any airman certificate upon conviction of the holder of such certificate of any violation of subsection (a) of section 742j-1 of Title 16, regarding the use or operation of an aircraft.[252]

(c) Transportation, distribution, and other activities relating to controlled substances

(1) The Administrator shall issue an order revoking the airman certificates of any person upon conviction of such person of a crime punishable by death or imprisonment for a term exceeding one year under a State or Federal law relating to a controlled substance (other than a law relating to simple possession of a controlled substance), if the Administrator determines that (A) an aircraft was used in the commission of the offense or to facilitate the commission of the offense, and (B) such person served as an airman, or was on board such aircraft, in connection with the commission of the offense or the facilitation of the commission of the offense. The Administrator shall have no authority under this paragraph to review the issue of whether an airman violated a State or Federal law relating to a controlled substance.

(2) The Administrator shall issue an order revoking the airman certificates of any person if the Administrator determines that (A) such person knowingly engaged in an activity that is punishable by death or imprisonment for a term exceeding 1 year under a State or Federal law relating to a controlled substance (other than any law relating to simple possession of a controlled substance), (B) an aircraft was used to carry out such activity or to facilitate such activity, and (C) such person served as an airman, or was on board such aircraft, in connection with such activity or the facilitation of such activity. The Administrator shall not revoke, and the National Transportation Safety Board on appeal under paragraph (3) shall not affirm the revocation of, a certificate under this paragraph on the basis of any activity if the holder of the certificate

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[252] 16 U.S.C. §742j-1 (1988) prohibits airborne hunting.

is acquitted of all charges contained in an indictment or information that relate to controlled substances and which arise from such activity.

(3) Prior to revoking an airman certificate under this subsection, the Administrator shall advise the holder thereof of the charges or any reasons relied upon by the Administrator for his proposed action and shall provide the holder of such certificate an opportunity to answer any charges and be heard as to why such certificate should not be revoked. Any person whose certificate is revoked by the Administrator under this subsection may appeal the Administrator's order to the National Transportation Safety Board and the Board shall, after notice and a hearing on the record, affirm or reverse the Administrator's order. In the conduct of its hearings, the National Transportation Safety Board shall not be bound by findings of fact of the Administrator. The filing of an appeal with the National Transportation Safety Board shall stay the effectiveness of the Administrator's order unless the Administrator advises the Board that safety in air commerce or air transportation requires the immediate effectiveness of his order, in which event the order shall remain effective and the Board shall finally dispose of the appeal within 60 days after being so advised by the Administrator. The person substantially affected by the National Transportation Safety Board's order may obtain judicial review of such order under the provisions of section 1486 of this title, and the Administrator shall be made a party to such proceedings.

(4) For purposes of this subsection, the term "controlled substance" has the meaning given such term by section 802(6) of Title 21.

(5) Waiver of revocation requirement.

Upon request of a federal or state law enforcement official, the Administrator may waive the requirements of paragraphs (1) and (2) that an airman certificate of any person be revoked if the Administrator determines that such waiver will facilitate law enforcement efforts.

## 2. NTSB Authority

49 USC App. §1903. General provisions

(a) Duties of Board

The Board shall--

(1) investigate or cause to be investigated (in such detail as it shall prescribe), and determine the facts, conditions, and circumstances and the cause or probable cause or causes of any--

(A) aircraft accident that is within the scope of the functions, powers, and duties transferred from the Civil Aeronautics Board under section 1655(d) of this title pursuant to title VII of the Federal Aviation Act of 1958, as amended;

(B) highway accident, including any railroad grade crossing accident, that it selects in cooperation with the States;

(C) railroad accident in which there is a fatality, substantial property damage, or which involves a passenger train;

(D) pipeline accident in which there is a fatality or substantial property damage;

(E) major marine casualty, except one involving only public vessels, occurring on the navigable waters or territorial seas of the United States, or involving a vessel of the United States, in accordance with regulations to be prescribed jointly by the Board and the Secretary of the department in which the Coast Guard is operating. Nothing in this subparagraph shall be construed to eliminate or diminish any responsibility under any other Federal statute of the Secretary of the department in which the Coast Guard is operating: Provided, That any marine accident involving a public vessel and any other vessel shall be investigated and the facts, conditions, and circumstances, and the cause or probable cause determined and made available to the public by either the Board or the Secretary of the Department in which the Coast Guard is operating; and

(F) other accident that occurs in connection with the transportation of people or property which, in the judgment of the Board, is catastrophic, involves problems of a recurring character, or would otherwise carry out the policy of this chapter.

Any investigation of an accident conducted by the Board under this paragraph (other than subparagraph (E)) shall have priority over all other investigations of such accident conducted by other federal agencies. The Board shall provide for the appropriate participation by other federal agencies in any such investigation, except that such agencies may not participate in the Board's determination of the probable cause of the accident. Nothing in this section impairs the authority of other federal agencies to conduct investigations of an accident under applicable provisions of law or to obtain information directly from parties involved in, and witnesses to, the transportation accident. The Board and other federal agencies shall assure that appropriate information obtained or developed in the course of their investigations is exchanged in a timely manner. The Board may request the Secretary of Transportation (hereafter in this chapter referred to as the "Secretary") to make investigations with regard to such accidents and to report to the Board the facts, conditions, and circumstances thereof (except in accidents where misfeasance or nonfeasance by the federal government is alleged), and the Secretary or his designees are authorized to make such investigations. Thereafter, the Board, utilizing such reports, shall make its determination of cause or probable cause under this paragraph;

(2) report in writing on the facts, conditions, and circumstances of each accident investigated pursuant to paragraph (1) of this subsection and cause such reports to be made available to the public at reasonable cost;

(3) issue periodic reports to the Congress, federal, state, and local agencies concerned with transportation safety, and other interested persons recommending and advocating meaningful responses to reduce the likelihood of recurrence of transportation accidents similar to those investigated by the Board and proposing corrective steps to make the transportation of persons as safe and free from risk of injury as is possible, including steps to minimize human injuries from transportation accidents;

(4) initiate and conduct special studies and special investigations on matters pertaining to safety in transportation including human injury avoidance;

(5) assess and reassess techniques and methods of accident investigation and prepare and publish from time to time recommended procedures for accident investigations;

(6) establish by regulation requirements binding on persons reporting (A) accidents and aviation incidents subject to the Board's investigatory jurisdiction under this subsection, and (B) accidents and aviation incidents involving public aircraft other than aircraft of the Armed Forces and the Intelligence Agencies;

(7) evaluate and assess the effectiveness and publish the findings of the Board with respect to the transportation safety consciousness and efficacy in preventing accidents of other government agencies;

(8) evaluate the adequacy of safeguards and procedures concerning the transportation of hazardous materials and the performance of other government agencies charged with ensuring the safe transportation of such materials; and

(9) review on appeal (A) the suspension, amendment, modification, revocation, or denial of any operating certificate or license issued by the

Secretary of Transportation under sections 1422,[253] 1429,[254] or 1431(c)[255] of this title and the revocation of any certificate of registration under section 1401(e)(2) of this title;[256] and (B) the decisions of the Commandant of the Coast Guard, on appeals from the orders of any administrative law judge revoking, suspending, or denying a license, certificate, document, or register in proceedings under section 239 of Title 46;[257] sections 239a[258] and 239b[259] of Title 46; or section 216b of Title 46.[260]

(b) Powers of Board

(1) The Board, or upon the authority of the Board, any member thereof, any administrative law judge employed by or assigned to the Board, or any officer or employee duly designated by the Chairman, may, for the purpose of carrying out this chapter, hold such hearings, sit and act at such times and places, administer such oaths, and require by subpoena or otherwise the attendance and testimony of such witnesses and the production of such evidence as the Board or such officer or employee deems advisable. Subpoenas shall be issued under the signature of the Chairman, or his delegate, and may be served by any person designated by the Chairman. Witnesses summoned to appear before the Board shall be paid the same fees and mileage that are paid witnesses in the courts of the United States. Such attendance of witnesses and production of evidence may be required from any place in the United States to any designated place of such hearing in the United States.

(2) Any employee of the Board, upon presenting appropriate credentials and a written notice of inspection authority, is authorized to enter any property wherein a transportation accident has occurred or wreckage from any such accident is located and do all things therein necessary for a proper investigation, including examination or testing of any vessel, vehicle, rolling

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[253] 49 U.S.C. App. §1422 (1988) (issuance, revocation of airman certificates).

[254] 49 U.S.C. App. §1429 (1988) (amendment, suspension, revocation of aircraft, air carrier, airport certificates).

[255] 49 U.S.C. App. §1431(c) (1988) (aircraft noise regulation).

[256] 49 U.S.C. App. §1401(e)(1) (1988) (aircraft registration certificates).

[257] Recodified at 46 U.S.C. §§6301 (investigation of marine accidents) & 7703 (grounds for suspension or revocation of merchant marine certificate).

[258] 46 U.S.C. §7503(a) (1988) (merchange mariner certificate actions for drug offenses), 7302 (issuance of merchange mariner's certificate).

[259] 46 U.S.C. §7503(b), 7704(b), (c) (1988) (merchange mariner certificate actions for drug offenses)).

[260] 46 U.S.C. §6301, 7703 (grounds for suspension or revocation of merchant mariner's certificate in conjunction with accident investigation) (1988).

stock, track, or pipeline component or any part of any such item when such examination or testing is determined to be required for purposes of such investigation. Any examination or testing shall be conducted in such manner so as not to interfere with or obstruct unnecessarily the transportation services provided by the owner or operator of such vessel, vehicle, rolling stock, track, or pipeline component, and shall be conducted in such a manner so as to preserve, to the maximum extent feasible, any evidence relating to the transportation accidents, consistent with the needs of the investigation and with the cooperation of such owner or operator. The employee may inspect, at reasonable times, records, files, papers, processes, controls, and facilities relevant to the investigation of such accident. Each inspection, examination, or test shall be commenced and completed with reasonable promptness and the results of such inspection, examination, or test made available. The Board shall have sole authority to determine the manner in which testing will be carried out under this paragraph and under section 1441(c) of this Appendix including determining the persons who will conduct the test, the type of test which will be conducted, and the persons who will witness the test. Such determinations are committed to the discretion of the Board and shall be made on the basis of the needs of the investigation being conducted by the Board and, where applicable, the provisions of this paragraph.

(3) In case of contumacy or refusal to obey a subpoena, an order, or an inspection notice of the Board, or of any duly designated employee thereof, by any person who resides, is found, or transacts business within the jurisdiction of any district court of the United States, such district court shall, upon the request of the Board, have jurisdiction to issue to such person an order requiring such person to comply forthwith. Failure to obey such an order is punishable by such court as a contempt of court.

(4) The Board is authorized to enter into, without regard to section 5 of Title 41, such contracts, leases, cooperative agreements, or other transactions as may be necessary in the conduct of the functions and the duties of the Board under this chapter, with any government entity or any person.

(5) The Board is authorized to obtain, and shall be furnished, with or without reimbursement, a copy of the report of the autopsy performed by state or local officials on any person who dies as a result of having been involved in a transportation accident within the jurisdiction of the Board and, if necessary, the Board may order the autopsy or seek other tests of such persons as may be necessary to the investigation of the accident: Provided, That to the extent consistent with the need of the accident investigation, provisions of local law protecting religious beliefs with respect to autopsies shall be observed.

(6) The Board is authorized to (A) use, on a reimbursable basis or otherwise, when appropriate, available services, equipment, personnel, and facilities of the Department of Transportation and of other civilian or military agencies and instrumentalities of the federal government; (B) confer with employees and use available services, records, and facilities of state, municipal, or local governments and agencies; (C) employ experts and consultants in accordance with section 3109 of Title 5; (D) appoint one or more advisory committees composed of qualified private citizens or officials of federal, state, or local governments as it deems necessary or appropriate, in accordance with the Federal Advisory Committee Act (5 U.S.C. App. I); (E) accept voluntary and uncompensated services notwithstanding any other provision of law; (F) accept gifts or donations of money or property (real, personal, mixed, tangible, or intangible); (G) enter into contracts with public or private nonprofit entities for the conduct of studies related to any of its functions; and (H) require payment or other appropriate consideration from federal agencies, and state, local, and foreign governments for the reasonable cost of goods and services supplied by the Board and to apply the funds received to the Board's appropriations.

(7) Whenever the Board submits or transmits any budget estimate, budget request, supplemental budget estimate, or other budget information, legislative recommendation, prepared testimony for congressional hearings, or comment on legislation to the President or to the Office of Management and Budget, it shall concurrently transmit a copy thereof to the Congress. No officer or agency of the United States shall have any authority to require the Board to submit its budget requests or estimates, legislative recommendations, prepared testimony for congressional hearings, or comments on legislation to any officer or agency of the United States for approval, comments, or review, prior to the submission of such recommendations, testimony, or comments to the Congress.

(8) The Board is empowered to designate representatives to serve or assist on such committees as the Chairman determines to be necessary or appropriate to maintain effective liaison with other federal agencies, and with state and local government agencies, and with independent standard-setting bodies carrying out programs and activities related to transportation safety.

(9) The Board, or an employee of the Board duly designated by the Chairman, may conduct an inquiry to secure data with respect to any matter pertinent to transportation safety, upon publication of notice of such inquiry in the Federal Register; and may require, by special or general orders, federal, state, and local government agencies and persons engaged in the transportation of people or property in commerce to submit written reports and answers to such

requests and questions as are propounded with respect to any matter pertinent to any function of the Board. Such reports and answers shall be submitted to the Board or to such employee within such reasonable period of time and in such form as the Board may determine. Copies thereof shall be made available for inspection by the public.

(10) The Board may at any time utilize on a reimbursable basis the services of the Transportation Safety Institute of the Department of Transportation (established for the purpose of developing courses and conducting training in safety and security for all modes of transportation) or any successor organization. The Secretary shall continue to make available such Institute or successor organization (A) to the Board for safety training of employees of the Board in the performance of all of their authorized functions, and (B) to such other safety personnel of federal, interstate, state, local, and foreign governments and nongovernmental organizations as the Board may from time to time designate in consultation with the Secretary. Utilization of such training at the Institute or successor organization by any designated nonfederal safety personnel shall be at a reasonable fee to be established periodically by the Board in consultation with the Secretary. Such fee shall be paid directly to the Secretary for the credit of the proper appropriation, subject to the requirements of any annual appropriation, and shall be an offset against any annual reimbursement agreement entered into between the Board and the Secretary to cover all reasonable direct and indirect costs incurred for all such training by the Secretary in the administration and operation of the Institute or successor organization. The Board shall maintain an annual record of all such offsets. In providing such training to federal employees, the Board shall be subject to chapter 41 of Title 5 (relating to training of employees).

(11)(A) Notwithstanding section 503(e) of the Act entitled "An Act making supplemental appropriations for the fiscal year ending September 30, 1987, and for other purposes", approved July 11, 1987 (5 U.S.C. 7301 note), the Board is authorized to obtain from the Secretary of Transportation, by written request, and shall be furnished--

(i) any report of a confirmed positive toxicological test, verified as positive by a medical review officer, which is conducted on an employee of the Department of Transportation, including any of its agencies, pursuant to post-accident, unsafe practice, or reasonable suspicion toxicological testing requirements of the Department, when that employee is reasonably associated with the circumstances of an accident or incident within the investigative jurisdiction of the Board; and

(ii) any laboratory record providing documentation that such test is confirmed positive.

(B) Except as provided in subparagraph (C), the Board shall maintain in confidence and exempt from public disclosure in accordance with section 552(b)(3) Title 5,--

(i) any laboratory record, made available under subparagraph (A), of a confirmed and verified toxicological test that reveals medical use of a drug permitted under applicable regulations; and

(ii) any medical information provided by the tested employee in connection with such test or in connection with a review of such test.

(C) The Board may use such a laboratory record for development of any evidentiary record in an investigation by the Board of an accident or incident if--

(i) the fitness of the employee who is the subject of the toxicological testing is at issue in the investigation; and

(ii) the use of that record is necessary in the development of such evidentiary record.

(12) Establish such rules and regulations as may be necessary to the exercise of its functions.

(c) Use of reports as evidence

No part of any report of the Board, relating to any accident or the investigation thereof, shall be admitted as evidence or used in any suit or action for damages growing out of any matter mentioned in such report or reports.

(d) Judicial review

Any order, affirmative or negative, issued by the Board under this chapter shall be subject to review by the appropriate court of appeals of the United States or the United States Court of Appeals for the District of Columbia, upon petition filed within 60 days after the entry of such order, by any person disclosing a substantial interest in such order. Such review shall be conducted in accordance with the provisions of chapter 7 of Title 5.

## 3. FAA Civil Penalty Authority

49 U.S.C.A. App. §1471. Civil penalties; notice and hearing; compromise; liens

(a)(1) Any person who violates (A) any provision of subchapter III,[261] IV,[262] V,[263] VI,[264] VII,[265] or XII[266] of this chapter[267] or of section 1501[268] or 1514,[269] or 1515(e)(2)(B)[270] of this title[271] or any rule, regulation, or order issued thereunder, or under section 1482(i) of this title, or any term, condition, or limitation of any permit or certificate issued under subchapter IV of this chapter, or (B) any rule or regulation issued by the United States Postal Service under this chapter, shall be subject to a civil penalty of not to exceed $1,000 for each such violation, except that a person who operates aircraft for the carriage of persons or property for compensation or hire (other than an airman serving in the capacity of an airman) shall be subject to a civil penalty not to exceed $10,000 for each violation of subchapter III, VI, or XII of this chapter, or any rule, regulation, or order issued thereunder, occurring after December 30, 1987, and except that the amount of such civil penalty shall not exceed $10,000 for each such violation that relates to the transportation of hazardous materials and for each such violation that relates to registration of recordation of an aircraft under subchapter V of this chapter. If such violation is a continuing one, each day of such violation, or each flight with respect to which such violation is committed, if applicable, shall constitute a separate offense. The amount of any such civil penalty which relates to the transportation of hazardous materials shall be assessed by the Secretary, or his delegate, upon written notice upon a finding of violation by the Secretary, after notice and an opportunity for a hearing. In determining the amount of such penalty, the Secretary shall take into account the nature, circumstances, extent, and gravity of the violation committed and, with respect to the person found to have committed such violation, the degree of culpability, any history of prior offenses, ability to pay, effect on ability to continue to do business, and such other matters as justice may require. The amount of any such civil penalty for any violation of any provision of subchapter IV of this chapter, or any rule, regulation, or order issued thereunder, or under section 1482(i) of this title, or any term, condition, or limitation of any permit or certificate issued under subchapter IV of this chapter shall be assessed by the Board only after notice and an opportunity for a hearing and after written notice upon a finding of violation by the Board. Judicial review of any order of the Board assessing such a penalty may be obtained only pursuant to section 1486 of this title. This subsection shall not apply to members of the Armed Forces of the United States, or those civilian employees of the Department of Defense who are subject to the provisions of the Uniform Code of Military Justice, while engaged in the performance of their official duties; and the appropriate military authorities shall be responsible for taking any necessary disciplinary action with respect thereto and for making to the Secretary of Transportation or Board, as appropriate, a timely report of any such action taken.

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[261] Organization and powers of FAA, Administrator.

[262] Air carrier economic regulation.

[263] Nationality, ownership of aircraft.

[264] Safety regulation of civil aeronautics.

[265] Aircraft accident investigation.

[266] Aviation security.

[267] 49 U.S.C. App. ch. 20, 49 U.S.C. App. §§1301-1557 (1988) (Federal Aviation Program).

[268] Rules for structures impinging airspace.

[269] Presidential suspension of airline operational authority.

[270] Notice of foreign airports with substandard security procedures.

[271] 49 U.S.C. App. (1988).

(2) Any civil penalty may be compromised by the Secretary of Transportation in the case of penalties provided for in subsections (c) and (d) of this section or violations of subchapters III, V, VI, or XII, or of section 1501, 1514, or 1515(e)(2)(B) of this Appendix, of this chapter, or any rule, regulation, or order issued thereunder, or by the National Transportation Safety Board in the case of violations of subchapter VII of this chapter, or any rule, regulation, or order issued thereunder, or by the United States Postal Service in the case of regulations issued by it. The amount of such penalty when finally determined or fixed by order of the Board, or the amount agreed upon in compromise, may be deducted from any sums which the United States owes to the person charged.

(3) Administrative assessment of certain registration and recordation violations

(A) General authority

The Administrator, or his delegate, may assess a civil penalty for a violation of subchapter V of this chapter, or a rule, regulation, or order issued thereunder, that relates to registration or recordation of an aircraft upon written notice and finding of violation by the Administrator.

(B) No reexamination of liability or amount

In the case of a civil penalty assessed by the Administrator under this paragraph, the issue of liability or amount of civil penalty shall not be reexamined in any subsequent suit for collection of such civil penalty.

(C) Continuing jurisdiction of district courts notwithstanding subparagraph (A), the United States district courts shall have exclusive jurisdiction of any civil penalty action initiated by the Administrator--

(i) that involves an amount in controversy in excess of $50,000;

(ii) that is an in rem action or in which an in rem action based on the same violation has been brought;

(iii) regarding which an aircraft subject to lien has been seized by the United States; and

(iv) in which a suit for injunctive relief based on the violation giving rise to the civil penalty has also been brought.

(D) Limitations

(i) Hearing

A civil penalty may be assessed by the Administrator under this paragraph only after notice and opportunity for a hearing on the record in accordance with section 554 of Title 5.

(ii) Violations

This paragraph only applies to civil penalties initiated by the Administrator after November 18, 1988.

(iii) Maximum amount

The maximum amount of a civil penalty that may be assessed by the Administrator under this paragraph in any case may not exceed $50,000. (b) In case an aircraft is involved in such violation and the violation is by the owner or person in command of the aircraft, such aircraft shall be subject to lien for the penalty: Provided, that this subsection shall not apply to a violation of a rule or regulation of the United States Postal Service.

(c) Whoever imparts or conveys or causes to be imparted or conveyed false information, knowing the information to be false and under circumstances in which such information may reasonably be believed, concerning an attempt or alleged attempt being made or to be made, to do any act which would be a crime prohibited by subsection (i), (j), (k), or (l) of section 1472 of this title, shall be subject to a civil penalty of not more than $10,000 which shall be recoverable in a civil action brought in the name of the United States.

(d) Except for law enforcement officers of any municipal or state government or officers or employees of the federal government, who are authorized or required within their official capacities to carry arms, or other persons who may be so authorized under regulations issued by the Administrator, whoever while aboard, or while attempting to board, any aircraft in, or intended for operation in, air transportation or intrastate air transportation, has on or about his person or his property a concealed deadly or dangerous weapon, which is, or would be, accessible to such person in flight shall be subject to a civil penalty of not more than $10,000, which shall be recoverable in a civil action brought in the name of the United States.

### 4. Civil Penalty Assessment Demonstration Program.

49 U.S.C.A. App. §1475 (West 1991)

(a) Civil penalty

The Administrator, or his delegate, may assess a civil penalty for a violation arising under this chapter or a rule, regulation, or order issued thereunder, upon written notice and finding of violation by the Administrator.

(b) No reexamination of liability or amount

In the case of a civil penalty assessed by the Administrator in accordance with this section, the issue of liability or amount of civil penalty shall not be reexamined in any subsequent suit for collection of such civil penalty.

(c) Continuing jurisdiction of district courts

Notwithstanding subsection (a) of this section, the United States district courts shall have exclusive jurisdiction of any civil penalty action initiated by the Administrator (1) that involves an amount in controversy in excess of $50,000; (2) that is an in rem action or in which an in rem action based on the same violation has been brought; (3) regarding which an aircraft subject to lien has been seized by the United States; and (4) in which a suit for injunctive relief based on the violation giving rise to the civil penalty has also been brought.

(d) Limitations

(1) Hearing

A civil penalty may be assessed under this section only after notice and opportunity for a hearing on the record in accordance with section 554 of Title 5.

(2) Violations

This section only applies to civil penalties initiated by the Administrator after December 30, 1987.

(3) Maximum amount

The maximum amount of a civil penalty that may be assessed under this section in any case may not exceed $50,000.

(4) Effective period

The provisions of this section shall only be in effect for the period beginning on December 30, 1987 and ending on August 1, 1992.

### 5. Procedural Provisions Applicable to FAA and NTSB

49 U.S.C. App. §1482. Complaints to and investigations by Administrator and Board

(a) Filing of complaints; complaints against members of the Armed Forces

Any person may file with the Secretary of Transportation or the Board, as to matters within their respective jurisdictions, a complaint in writing with respect to anything done or omitted to be done by any person in contravention of any provisions of this chapter, or of any requirement established pursuant thereto. If the person complained against shall not satisfy the complaint and there shall appear to be any reasonable ground for investigating the complaint, it shall be the duty of the Secretary of Transportation or the Board to investigate the matters complained of. Whenever the Secretary of Transportation or the Board is of the opinion that any complaint does not state facts which warrant an investigation or action, such complaint may be dismissed without hearing. In the case of complaints against a member of the Armed Forces of the United States acting in the performance of his official duties, the Secretary of Transportation or the Board, as the case may be, shall refer the complaint to the Secretary of the department concerned for action. The Secretary shall, within 90 days after receiving such a complaint, inform the Secretary of Transportation or the Board of his disposition of the complaint, including a report as to any corrective or disciplinary actions taken.

(b) Investigations on initiative of Secretary or Board

The Secretary of Transportation or Board, with respect to matters within their respective jurisdictions, is empowered at any time to institute an investigation, on their own initiative, in any case and as to any matter or thing within their respective jurisdictions, concerning which complaint is authorized to be made to or before the Secretary of Transportation or Board by any provision of this chapter, or concerning which any question may arise under any of the provisions of this chapter, or relating to the enforcement of any of the provisions of this chapter. The Secretary of Transportation or the Board shall have the same power to proceed with any investigation instituted on their own motion as though it had been appealed to by complaint.

(c) Entry of orders for compliance with chapter

If the Secretary of Transportation or the Board finds, after notice and hearing, in any investigation instituted upon complaint or upon their own initiative, with respect to matters within their jurisdiction, that any person has failed to comply with any provision of this chapter or any requirement established pursuant thereto, the Secretary of Transportation or the Board shall, subject to section 1502(a) of this title, issue an appropriate order to compel such person to comply therewith.

(d) Power to prescribe rates and practices of air carriers

(1) Except as provided in paragraph (2) or (4) of this subsection, whenever, after notice and hearing, upon complaint, or upon its own initiative, the Board shall be of the opinion that any individual or joint rate, fare, or charge demanded, charged, collected or received by any air carrier for interstate air.

## B. Other Administrative Civil Penalty Authority

7 U.S.C.A. §13a (CFTC assessment of penalties against commodity exchanges)

7 U.S.C.A. §149 (USDA assessment of civil penalties for violation of insect pest vehicle inspection rules)

7 U.S.C.A. §150gg (USDA assessment of civil penalties for violation of plant pest permit and documentation rules)

7 U.S.C.A. §163 (USDA assessment of civil penalties for violation of nursery stock rules)

7 U.S.C.A. §193 (USDA assessment of civil penalties for violation of packers and stockyards rules)

7 U.S.C.A. §228b-2 (USDA assessment of civil penalties for violation of live poultry dealer rules)

7 U.S.C.A. §608c (USDA assessment of civil penalties for violation of handlers of agricultural commodities and agricultural adjustment benefits rules)

7 U.S.C.A. §3805 (USDA assessment of civil penalties for violation of swine health regulations)

Fed. Reserve System Hearing Rules, 12 CFR s 263.28 , 12 U.S.C.A. foll. s 248

15 U.S.C. §78u-2 (SEC civil remedies in administrative proceedings)

15 U.S.C. §2615 (EPA assessment of civil penalties for violation of 15 U.S.C. §2614 regarding toxic substance control)

15 U.S.C. §3414(b) (FERC assessment of civil penalties for violation of Natural Gas Act)

16 U.S.C. §4307 (civil penalties associated with Federal Cave Resources protection)

21 U.S.C. §135a (Animals, meats and dairy products smuggling penalties)

30 U.S.C.§1268 (surface mining control and reclamation penalties)

42 U.S.C. §7524 (motor vehicle emission and fuel standards civil penalties)

42 U.S.C. §9609 (Superfund civil penalties and awards)

43 U.S.C. §1656 (Alaska pipeline civil penalties)

## C. Conference Recommendation 90-1

Recommendation 90-1, 55 Fed.Reg. 34209, ___, (to be codified at 5 CFR §305.90-1).

1. Congress should authorize on a permanent basis the administrative imposition of civil money penalties for violations of the Federal Aviation Act (Act) and its implementing safety regulations.

2. Congress should eliminate the current ceiling of $50,000 applicable to administratively-imposed civil money penalties for violations of the Act and its implementing safety regulations.

3. Legislation providing for continued administrative imposition of civil money penalties should make explicit that the Federal Aviation Administration (FAA) has administrative discretion to compromise disputed cases without requiring a formal finding of a violation.

4. As long as adjudicatory responsibility is lodged at the Department of Transportation, the Department should adopt revised rules of practice governing adjudication of civil money penalty cases following notice-and-comment procedures. Such rules should address the following issues:

a. Separation of functions: The regulations should make clear that employees with investigatory or prosecutorial responsibilities in a case in this program will not communicate with the administrative law judge or agency decisionmaker in that case or a factually related case, except as counsel or a witness in the public proceedings.

b. Testimony of FAA employees:

1. The regulations should permit FAA employees to testify as to facts relevant to any disputed issue. Within the scope of this rule, hearsay testimony from FAA employees should be treated the same as other hearsay testimony.

2. FAA employees testifying as experts should be subject to full cross examination.

c. Designation of documents: The regulations should avoid denominating the document used to commence formal civil penalty proceedings as an "order", and should use a term such as "complaint."

d. Use of briefs: The regulations should permit these filing of post-hearing briefs whenever, in the ALJ's view, the interests of justice so require.

e. Explanation of basis for sanctions imposed: The regulations should establish a uniform standard for explanation of sanctions imposed in initial decisions, regardless of whether the ALJ affirms or modifies the proposed sanction.

## D. Conference Recommendation 79-3

1 CFR §305.79-3. Agency Assessment and Mitigation of Civil Money Penalties (Recommendation No. 79-3).

(a) The civil money penalty has become one of the most widely used techniques in the enforcement programs of federal administrative agencies. Most regulatory offenses punishable by civil penalties involve adverse social consequences of private business activity. The motivational impact of these penalties depends in large part on the certainty of imposition and uniformity of amount, although some cases may require individualized tailoring to the circumstance of the offender so as to remove the economic benefit of the illegal conduct. Other civil penalties may also serve a secondary function of compensating society for the harm caused by unlawful conduct.

(b) Recommendation 72-6 urged that the advantages of civil money penalties would be best achieved through an "administrative imposition system" in which the agency would be empowered to adjudicate the violation and impose the penalty after a trial-type hearing, subject to "substantial evidence" judicial review. Such a system, it was stated, would avoid the delays, high costs, and jurisdictional fictions inherent in the traditional and most common system of imposing civil money penalties by a court in a civil action initiated on behalf of the agency by the Department of Justice.

(c) Since adoption of that Recommendation in 1972, the use of civil money penalties in general and of administratively imposed civil money penalties in particular has increased significantly, and the constitutionality and desirability of administratively imposed penalties has been widely recognized.

(d) Experience has shown that agencies play a crucial role and exercise broad discretion in the administration of civil penalty programs, whether or not the statute in question authorizes an administrative imposition system. Agencies possessing such authority have found it efficient to try to resolve cases before the formal hearing stage, through settlement and negotiation. Those agencies not possessing administrative imposition authority operate under a wide variety of statutes: some make no express reference to an agency role in the penalty process, while others confer on the agency only a power to "assess" or to "mitigate" penalties, thereby expressly or implicitly reserving to the respondent the right to seek a subsequent de novo fact-finding hearing by the court in a collection proceeding. Agencies typically exercise their statutory authority to "mitigate" in resolving contested penalty assessments prior to the initiation of formal enforcement action. In these recommendations the term "mitigation" refers to any informal process of resolving a contested initial penalty assessment.

(e) Whatever the statutory framework, the enforcing agency typically makes the initial assessment, and provides a process for mitigation of the penalty. Thus, both where there exists administrative imposition authority and where such authority does not exist, agencies and respondents customarily utilize these initial assessment and mitigation processes to resolve the great majority of civil money penalty cases without reaching the stage of formal administrative adjudication or court collection proceeding.

(f) These informal processes for the initiation and termination of civil penalty proceedings represent an area of previously unstudied and largely discretionary agency action. Appropriate standards and structures for the exercise of such discretion are needed to improve the consistency, efficiency and openness of agency assessment and mitigation processes.

(g) The recommendations that follow focus on: (1) The need for agencies to develop standards for determining penalty amounts, (2) agency procedures for initially assessing penalties, (3) agency mitigation procedures, and (4) the use by agencies of evidentiary hearings to impose civil penalties where such a procedure, though not required by statute, might result in a limited scope of judicial review.

## Recommendation

### A. Standards for Determination of Penalty Amount

1. Agencies enforcing regulatory statutes, violation of which is punishable by a civil money penalty, should establish standards for determining appropriate penalty amounts for individual cases. In establishing standards, agencies should specify the factors to be considered in determining the appropriate penalty amount in a particular case. To the extent practicable, agencies should specify the relative weights to be attached to individual factors in the penalty calculation, and incorporate such factors into formulas for determining penalty amounts or into fixed schedules of prima facie penalty amounts for the most common types or categories of violation. A penalty intended to deter or influence economic behavior should, at a minimum, be designed to remove the economic benefit of the illegal activity, taking into account the documented benefit and the likelihood of escaping detection. Penalty standards should, in addition, specify whether and to what extent the agency will consider other factors such as compensation for harm caused by the violation or the impact of the penalty on the violator's financial condition. In order to reduce the cost of the penalty calculation process and increase the predictability of the sanction, simplifying assumptions about the benefit realized from or the harm caused by illegal activity should be utilized.

2. Agencies should periodically evaluate the continuing effectiveness of their penalty standards. Such evaluations should be based upon the results of compliance surveys and internal audits of agency assessment and mitigation decisions as well as data on the nature and frequency of violations routinely generated by the agency's enforcement program.

3. Agencies should make such standards known to the public to the greatest extent feasible through rulemaking or publication of policy statements. Such an approach is especially desirable where adjudications that produce written decisions are rare.

4. Agencies should collect and index those written decisions made in response to mitigation requests or after agency assessment hearings, and make such decisions available to the public except to the extent that their disclosure is prohibited by law. Whenever a respondent cites a previous written decision as a precedent for the agency to follow in the respondent's case, the agency should either do so, distinguish the two cases, or explain its reasons for not following the prior decision.

### B. Initial Assessment of Penalties.

1. Agencies should give adequate written notice to the respondent of the factual and legal basis for, and amount of, the penalty assessment.

2. Agencies should not mechanically assess variable civil money penalties at the statutory maximum if reliable evidence in their possession indicates the presence of mitigating factors. Nor, if they possess such evidence, should agencies assess at the statutory level fixed penalties which are subject to an express administrative "mitigation" authority.

3. The greater the degree to which an agency decentralizes its penalty assessment authority, the more it should structure the exercise of that authority by the use of highly specific standards. Agencies should not ordinarily delegate discretionary authority to assess civil money penalties to investigative personnel unless the delay inherent in review by an independent assessment official would materially impair the effectiveness of the enforcement process.

Respondents in civil money penalty cases have a right to a trial-type hearing at either the administrative or judicial level. It is nevertheless desirable that agencies establish fair and economical procedures whereby respondents may informally contest the initial assessment of civil penalties without the necessity of going forward to trial-type hearings. These procedures should be governed by the following principles:

1. Agencies should provide the respondent with a right to reply in writing to a penalty claim.
2. Agency staff should not refuse a reasonable request to discuss a penalty claim orally. But an informal Conference need not be built into the process except in those categories of cases where the use of written communications is likely to prove inadequate because of such factors as the unsophistication of violators or the prevalence of factual disputes.
3. Agencies should consider providing an opportunity for administrative review of a decision denying a request for mitigation.
4. Agency decisions on mitigation requests should be in writing and should be accompanied by a brief indication of the grounds for the decision.
5. In regulatory programs typically involving the imposition of small penalties, agencies may appropriately rely most heavily on readily ascertainable standards of liability, fixed schedules of prima facie penalty amounts for the most common types of categories of violations, and highly objective inspection procedures. Opportunity for mitigation should be narrowly confined and mitigation requests entertained only if in written form.
6. In regulatory programs typically involving the imposition of large penalties, agencies may appropriately provide an opportunity to a respondent to present a request for mitigation, orally or in writing, request an oral Conference thereon, receive a written decision, and submit a written petition for review of such decision or for compromise of such claim at a higher agency level.

## D. Evidentiary Hearings

As expressed in Recommendation 72-6, it is desirable that agencies be given express authority to employ the procedures of adjudication on the record pursuant to the APA, 5 U.S.C. 554-557, for the imposition of civil money penalties. Where its statute does not provide for such procedure but confers upon the agency authority to "assess" or to "mitigate" a penalty, particularly if the agency is required to conduct a "hearing", the agency should consider establishing such procedures by regulation, especially where by doing so a de novo proceeding upon judicial review could be avoided. Where such a hearing procedure has in fact been observed by the agency, and the statute does not provide for de novo judicial proceedings, the court should ordinarily utilize a limited scope of review of such agency action imposing civil money penalties.

(44 Fed.Reg. 38824, July 3, 1979)

## E. Conference Recommendation 72-6

1 CFR §305.72-6. Civil Money Penalties as a Sanction (Recommendation 72-6).

(a) federal administrative agencies enforce many statutory provisions and administrative regulations for violation of which fixed or variable civil money penalties may be imposed.[272] During Fiscal 1971, seven executive departments and thirteen independent agencies collected well in excess of $10 million, in over 15,000 cases; all evidence points to a doubling or tripling dollar magnitude and substantially increasing caseload within the next few years.

(b) Increased use of civil money penalties is an important and salutary trend. When civil money penalties are not available, agency administrators often voice frustration at having to render harsh "all-or-nothing decisions" (e.g., in license revocation proceedings), sometimes adversely affecting innocent third parties, in cases in which enforcement purposes could better be served by a more precise measurement of culpability and a more flexible response. In many areas of increased concern (e.g., health and safety, the environment, consumer protection) availability of civil money penalties might significantly enhance an agency's ability to achieve its statutory goals.

(c) In developing a range of sanctions adequate to meet enforcement needs, Congress and agencies must often determine whether a "criminal fine" or a "civil money penalty", or both, should be applied to a given regulatory offense. The choice they make has large consequences. Criminal penalties expose an offender to the disgrace and disabilities associated with "convictions"; they require special procedural and other protections; and they can not be imposed administratively. These factors make it appropriate to consider whether criminal sanctions should not be supplemented or replaced by civil money penalties.

(d) Under most money penalty statutes, the penalty cannot be imposed until the agency has succeeded in a de novo adjudication in federal district court, whether or not an administrative proceeding has been held previously. The already critical overburdening of the courts argues against flooding them with controversies of this type, which generally have small precedential significance.

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[272] For purposes of this recommendation, no distinction has been drawn between sanctions denominated "money penalties" and sanctions denominated "forfeitures" (e.g., in FCC legislation) and "fines" (e.g., in Postal Service legislation) so long as: (i) The sanction is classified as civil and (ii) money is, in fact, subject to collection by an agency or a court. Excluded are situations involving penalties or liquidated damages assessed pursuant to the terms of a government contract or sums withheld or recovered for failure to comply with the terms of a government grant.

(e) Because of such factors as considerations of equity, mitigating circumstances, and the substantial time, effort and expertise such litigation often requires in cases usually involving relatively small sums (an average of less than $1,000 per case), agencies settle well over 90 percent of their cases by means of compromise, remission, or mitigation. Settlements are not wrong per se, but the quality of the settlements under the present system is a matter of concern. Regulatory needs are sometimes sacrificed for what is collectible. On the other hand, those accused sometimes charge that they are being denied procedural protections and an impartial forum and that they are often forced to acquiesce in unfair settlements because of the lack of a prompt and economical procedure for judicial resolution. Moreover, several agency administrators warn that some of the worst offenders, who will not settle and cannot feasibly be brought to trial, are escaping penalties altogether.

This recommendation is intended to meet the problems posed above.

## Recommendation

D. Desirability of Civil Money Penalties as a Sanction.

1. Federal administrative agencies should evaluate the benefits which may be derived from the use (or increased use) of civil money penalties as a sanction. Such penalties should not be adopted as a means of supplanting or curtailing other private or public civil remedies.
2. Civil money penalties are often particularly valuable, and generally should be sought, to supplement those more potent sanctions already available to an agency--such as license suspension or revocation--whose use may prove: (a) Unduly harsh for relatively minor offenses, or (b) infeasible because, for example, the offender provides services which cannot be disrupted without serious harm to the public.
3. Each federal agency which administers laws that provide for criminal sanctions should review its experience with such sanctions to determine whether authorizing civil money penalties as another or substitute sanction would be in the public interest. Such authority for civil money penalties would be particularly appropriate, and generally should be sought, where offending behavior is not of a type readily recognizable as likely to warrant imprisonment.

B. Adjudication of Civil Money Penalty Cases in an Administrative Imposition System. 1. In some circumstances it is desirable to commit the imposition of civil money penalties to agencies themselves, without subjecting agency determinations to de novo judicial review. Agencies should consider asking Congress to grant them such authority.[273]

Factors whose presence tends to commend such a course with respect to a particular penalty provision include the following:

(a) A large volume of cases likely to be processed annually;
(b) The availability to the agency of more potent sanctions with the resulting likelihood that civil money penalties will be used to moderate an otherwise too harsh response;
(c) The importance to the enforcement scheme of speedy adjudications;
(d) The need for specialized knowledge and agency expertise in the resolution of disputed issues;
(e) The relative rarity of issues of law (e.g., statutory interpretation) which require judicial resolution;
(f) The importance of greater consistency of outcome (particularly as to the penalties imposed) which could result from agency, as opposed to district court, adjudications; and
(g) The likelihood that an agency (or a group of agencies in combination) will establish an impartial forum in which cases can be efficiently and fairly decided.

Considerations such as those set forth above should be weighed heavily in favor of administrative imposition when the usual monetary penalty for an offense or a related series of offenses would be relatively small, and should normally be decisive when the penalty would be unlikely to exceed $5,000. However, the benefits to be derived from civil money penalties, and the administrative imposition thereof, should also be considered when the penalties may be relatively large.

2. An administrative imposition system should provide:
   (a) For an adjudication on the record pursuant to the Administrative Procedure Act, 5 U.S.C. 554-57 (1970), at the option of the alleged offender or the agency;
   (b) For finality of an agency's decision unless appealed within a specified period of time;
   (c) That, if the person on whom the penalty is imposed appeals, an agency's decision will be reviewed in United States Courts of Appeals

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[273] Due to the special procedures and status of the United States Tax Court, the rationale for administrative imposition may have only limited applicability to civil money penalties administered by the Internal Revenue Service.

under the substantial evidence rule in accordance with the Administrative Procedure Act, 5 U.S.C. 706(e);

(d) That issues made final by reason of (b) above and issues which were raised, or might have been raised, in a proceeding for review under (c) above may not be raised as a defense to a suit by the United States for collection of the penalty. Agencies should adopt rules of practice which will enable just, inexpensive and speedy determinations. They should provide procedures for settlement by means of remission, mitigation or compromise.

## Report for Recommendation 91-9

# Specialized Courts in Administrative Law

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This report was prepared for the consideration of the Administrative Conference of the United States. The views expressed are those of the author and do not necessarily reflect those of the members of the Conference or its committees except where formal recommendations of the Conference are cited.

In administrative law, specialized courts are a nostrum for occasional use (prn).[1] They offer important institutional advantages, yet at a price that has restricted their use. Their existence has owed more to history than to any grand theory of government organization. Congress has created, restructured, and abandoned particular courts, sometimes seeming merely to tinker with them. They have coexisted with generalist courts that decide many issues which appear to be equally good--or bad--candidates for separate treatment.

Today, caseload pressures on the federal courts have led to renewed interest in creating or expanding specialized courts to relieve the crush.[2] Since institutional change should pursue principle as well as expediency, I write to offer considerations bearing on the use of these courts in administrative law, and to suggest creation of a new administrative court with jurisdiction over cases meeting certain criteria.

All three constitutional branches have performed specialized adjudication in ways that present only subtle functional distinctions. Our government includes Article I legislative courts, Article II executive adjudicators, and Article III judges with specialized dockets. Although no very clear normative or constitutional theory has emerged to limit congressional allocations of business among these entities, courts and commentators do display concerns that guide prescriptive analysis. A rough consensus exists that some issues should remain in generalized federal courts, and that others rest comfortably in specialized fora.

My goal here is to unravel the rather tangled history of specialized adjudication enough to identify the programs where it seems most usefully employed, and to offer some principles for its architecture. After a quick review of general considerations bearing on specialized courts, I canvass their history to date. The historical record is mixed enough to induce consideration of the merits of varying degrees of independence for adjudicators both inside and outside agencies. Some notes on identifiable constitutional considerations then precede conclusions regarding the best uses of specialized courts in modern administrative law.

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[1] I review below the history of the specialized courts that have special significance for administrative review. There are others, for example Bankruptcy Courts, the Court of Military Appeals, the Foreign Intelligence Surveillance Court, and the Special Court, Regional Rail Reorganization Act of 1973.

[2] See, e.g., Report of the Federal Courts Study Committee (1990); Report of the American Bar Ass'n Standing Committee on Federal Judicial Improvements, The United States Courts of Appeals: Reexamining Structure and Process after a Century of Growth (1989).

# I. The Benefits and Costs of Specialized Courts

The general benefits and costs of specialized courts are well known.[3] First, they relieve the caseload burdens of other courts, perhaps substantially. Gauging docket relief is not, however, a matter of simply counting filings shifted from one court to another. What matters is the amount of time and effort spared the judges. The federal judiciary has compensated for caseloads that rise faster than new judgeships by deciding many cases in a more summary manner (for example without argument or opinion), and by delegating many tasks to law clerks and other support personnel, whose numbers have multiplied.[4] Cases that now occupy the summary docket do not necessarily deserve such treatment--they yield to cases placing higher claims on the judges' time. Victims of this process of triage could receive more attention in alternate fora, while somewhat relieving the strain on the most overloaded part of the system. And some business that now receives the full attention of federal judges could be shunted elsewhere, for maximum caseload relief. Yet caution is necessary--devotion of scarce resources to existing cases implies their importance. So the trick is to find the cases that impose the greatest burdens on the courts compared to their importance.

Second, specialized judges can become expert in the substantive and procedural issues surrounding particular programs, especially highly technical ones. More accurate decisions should result. Expertise can take several forms. Some subjects draw on extralegal training, for example the use of engineering and science in patents or environmental law. Much of this sort of expertise relates to issues of fact and policy. Although it would not be efficient for generalized courts to emphasize expensive training in the background of their judges or staff, the opposite may be true of specialized courts. Legal expertise, as in tax, may depend on long study of a complex body of law. Here also, a generalized court may waste knowledge that a specialized one could seek--or could develop through exposure to its docket.

Third, division of labor promotes efficiency. Due to expertise and a limited caseload, specialized courts can produce expeditious decisions. The number of judges can be adjusted to the historical caseload. There is, however, some special vulnerability to exogenous factors affecting the underlying controversies. For example, the number of social security disability cases rose sharply in the early 1980s, and then receded.[5]

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[3] The considerations that I outline in this section are discussed in Dreyfuss, *Specialized Adjudication*, 1990 B.Y.U. L. REV. 377, 377-82; Revesz, *Specialized Courts and the Administrative Lawmaking System*, 138 U. PA. L. REV. 1111, 1116-21 (1990); Jordan, *Specialized Courts: A Choice?*, 76 NW. U. L. REV. 745, 747-48 (1981); Currie & Goodman, *Judicial Review of Federal Administrative Action: Quest for the Optimum Forum*, 75 COLUM. L. REV. 1, 63-75 (1975).

[4] R. Posner, *The Federal Courts, Crisis and Reform* Ch. 4 (1985).

Finally, specialized courts reduce or eliminate intercourt conflicts, promoting a uniform national body of law. A pattern of conflicting court orders, uncertainty about the law, and forum shopping has traditionally led to their establishment. This advantage has special importance now that caseloads have effectively decentralized the federal courts by removing the likelihood of Supreme Court review of most court of appeals decisions.[6] A single, specialized court can articulate a unitary body of law in a way that 13 courts of appeals cannot approach.

A primary cost of specialization is loss of the generalist perspective. A premise of our nation's usual resort to courts of general jurisdiction is that sound decisionmaking results from exposure to a wide range of problems, rather than from initiation into an arcane set of mysteries. Generalization has two related benefits. Some loosely related legal issues may produce direct cross-fertilization of insights. More often, a wider perspective aids judgment by forestalling the exaggerated importance that long immersion may lend to some social problem. A broadened perspective may be especially important in those who review the action of bureaucracies that are themselves narrowly focused.

Also, specialization may diminish the prestige of a court. It will be staffed by lower caliber judges, those who can tolerate life on the assembly line. Loss of prestige can fundamentally impair a court's power. Part of a court's success in obtaining compliance with its mandates flows from the respect others have for it. Depending on the subject matter that is segregated, there is also a risk of impairing the remaining generalist courts by leaving them with less interesting fare.

Specialization can produce bias problems, in two ways. First, the appointments process may be distorted as nominees are selected and confirmed for their views on specific issues. Pressure on the appointing authority flows from two sources. Interest groups affected by a court's decisions have a strong incentive to advance their allies. Yet groups vary in their intrinsic cohesion and their ability to overcome free rider effects to achieve effective organization. Government programs that affect relatively diffuse and disorganized segments of the public, for example some benefits programs, may not encounter forceful interest group response, although segments of the bar that serve such groups can sometimes act as surrogates.[7] Agencies reviewed by a court will always take an active interest in appointments to it. They will discover insight and eminence in their own alumni.

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[5] Galanter, *The Life and Times of the Big Six: or, The Federal Courts Since the Good Old Days*, 1988 WIS. L. REV. 921, 929-31.

[6] See Strauss, *One Hundred Fifty Cases per Year: Some Implications of the Supreme Court's Limited Resources for Judicial Review of Agency Action*, 87 COLUM. L. REV. 1093 (1987).

Even if initially disinclined to press for favorable appointments, both interest groups and agencies may feel a need to offset the activities of the other. To be sure, the net effect of the process may be to cancel out these interested influences, although it takes some faith to believe that will occur. In any event, the pool of eligible candidates may consist of former agency staff and a specialized segment of the bar. To the extent that qualifications for the court converge with those for the principal executive positions in the agency reviewed, excessive convergence of perspective in agency and court may also occur. These problems of litmus tests and limited pools do not usually confront generalist courts.

Second, specialization can distort application of the review standard. Growing expertise may lead courts to substitute their judgment for an agency, creating an overly dominant oversight body. On the other hand, such a court can become too friendly with an agency that it reviews regularly, or with interests that dominate it. Those who litigate repeatedly before a particular court possess natural advantages over occasional participants.[8] Again, these effects will not always counterbalance even when both agencies and interest groups regularly appear. Moreover, it is difficult for outside monitors in Congress or the public to identify distortions in the standard. Although gross rates of reversal may be suggestive, the frame of reference is suspect. For example, a high rate of reversal compared to generalist courts with similar responsibilities (if there are any) may mean that review is too stringent, or only that the agency is unusually inept.

## II. A Brief History of Specialized Courts

Specialized courts of past and present have manifested the foregoing advantages and disadvantages in a balance that lies in the eyes of the observer. Obviously, the stakes are high. I review the history of these courts briefly to identify lessons about their future prospects.

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[7] M. Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups*, Ch. 6 (1965).

[8] Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC. REV. 95, 97-104 (1974).

## A. The Federal Circuit and Its Predecessors

In 1982 Congress formed the Court of Appeals for the Federal Circuit (CAFC)[9] by combining and rearranging courts whose long existence testifies to some success. The evolution of these courts and the nature of their treatment in 1982 reveal both the ad hoc approach of Congress to these issues and the inefficiencies that have sometimes resulted. In addition, the structure of the new CAFC provides a possible model for other specialized courts.

The CAFC took over some functions of our first permanent specialized court, the Court of Claims, which was established in 1855 to relieve Congress of the burden of deciding claims against the United States.[10] Although Congress meant it to be an Article III court, the Supreme Court initially refused to review its judgments because they were subject to administrative review.[11] The Court of Claims evolved into an appellate forum, reviewing decisions of commissioners that it appointed. Its major responsibilities were to adjudicate contract and other nontort claims under the Tucker Act.[12] Congress folded its appellate functions into the new CAFC, and created a new Article I trial court, the Claims Court.[13]

The most important element of the CAFC is the former Court of Customs and Patent Appeals (CCPA).[14] It began as the Court of Customs Appeals in 1909. The court, created to relieve the dockets of the circuit courts of customs matters, heard appeals from a succession of customs adjudicators.[15] The CCPA became an odd hybrid in 1929, when Congress responded to longstanding calls for expertise and uniformity in patent matters by adding jurisdiction over appeals from the Commissioner of Patents.[16] A more prosaic purpose may account for passage of this legislation, however. Congress transferred patent appeals from an overburdened D.C. Circuit to an underutilized group of customs judges.[17]

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[9] Federal Courts Improvements Act, Pub. L. No. 97-164, 96 Stat. 25 (codified in scattered sections of 28 U.S.C.). *See generally* Adams, *The Court of Appeals for the Federal Circuit: More Than a National Patent Court*, 49 MO. L. REV. 43 (1984).

[10] Act of Feb. 24, 1855, ch. 122, 10 Stat. 612; *see generally* Cowen, Nichols & Bennett, The United States Court of Claims: A History, 216 Ct. Cls. 1 (1978).

[11] Gordon v. United States, 69 U.S. (2 Wall.) 561 (1864). Curative legislation then removed the offending provision. Act of March 17, 1866, ch. 19, 14 Stat. 9.

[12] Act of March 3, 1887, ch. 359, 24 Stat. 505. It also had, however, some administrative duties to report to Congress on private relief bills. In 1933, the Supreme Court once again held the Court to be an Article I entity. Williams v. United States, 289 U.S. 553 (1933). Eventually, Congress once again brought it back within Article III; Act of July 28, 1953, 67 Stat. 226; see S. Rep. No. 261, 83d Cong., 1st Sess. (1953). This time, the Supreme Court acquiesced.Glidden Co. v. Zdanok, 370 U.S. 530 (1962).

[13] 28 U.S.C. §§171-72. The Claims Court retains the duty to report to Congress on private bills. 28 U.S.C. §§1492, 2509. Staffed by the commissioners of the defunct Court of Claims, it rides circuit nationwide.

[14] Act of August 5, 1909, ch. 6, 36 Stat. 11, 91, 105. My history of this court is drawn from G. Rich, *A Brief History of the United States Court of Customs and Patent Appeals* (1980); F. Frankfurter & J. Landis, *The Business of the Supreme Court*, 174-84 (1928); H. Friendly, *Federal Jurisdiction: A General View*, 154-61 (1973); Nathanson, *The Administrative Court Proposal*, 57 VA. L. REV. 996, 1008-09 (1971).

Unhappily, creation of the CCPA did little to consolidate decision of patent law. Regional federal courts continued to hear many patent and trademark infringement suits. Eminent federal judges complained that they did not feel competent to decide patent litigation: "I am unable to perceive why we should not insist on the same level of scientific understanding on the patent bench that clients demand of the patent bar, or why lack of such understanding by the judge should be deemed a precious asset."[18]

In such a decentralized and inexpert system, intercircuit divergence was considerable; forum shopping was rampant.[19] In addition, for two reasons the generalist federal courts displayed an overall difference in outlook from that of the CCPA. First, structural features of both the Patent and Trademark Office and the CCPA made them overly favorable to granting patents. The problem was that the PTO heard ex parte applications for patents, and the CCPA heard only appeals from denials. Second, for a time the patent bar, which favors lenient patentability, held sway over appointments to the CCPA.[20] The specialists in the PTO and the CCPA began producing decisions at marked variance from those of the federal courts, which accorded their decisions little respect.[21]

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[15] These were: the old Board of General Appraisers, Act of June 10, 1890, Ch. 407, 26 Stat. 131, 137; an Article I Customs Court, Act of June 17, 1930, Ch. 497, 46 Stat. 590, 737; an Article III Customs Court, Act of July 14, 1956, ch. 589, 70 Stat. 532; and the Article III Court of International Trade, Pub. L. No. 96-417, 94 Stat. 1727 (1980). The CIT was given broad jurisdiction over international trade matters in an effort to stem jurisdictional confusion with the district courts. H. Rep. No. 96-1235, 96th Cong., 2d Sess. 18-19 (1980). *See generally* Cohen, *The New United States Court of International Trade*, 20 COLUM. J. TRANSNAT'L L. 277 (1981). The CIT has been relatively free of controversy. Dreyfuss, *supra* note 3, at 403.

[16] Act of March 2, 1929, ch. 488, 45 Stat. 1475.

[17] S. Rep. No. 784, 70th Cong., 1st Sess. (1928). After some early doubts, the CCPA was held to be an Article III court. The doubts were due to dicta in Ex parte Bakelite Corp., 279 U.S. 438 (1929). Congress legislated to clarify the court's status, Pub. L. No. 85-755, 72 Stat. 848. The Court agreed in Glidden Co. v. Zdanok, 370 U.S. 530 (1962).

[18] H. Friendly, *supra* note 14, at 157 (also reporting the views of Learned Hand).

[19] This paragraph reports conclusions of a study by Dreyfuss, *The Federal Circuit: A Case Study in Specialized Courts*, 64 N.Y.U. L. REV. 1 (1989).

[20] Baum, *Judicial Specialization, Litigant Influence, and Substantive Policy: The Court of Customs and Patent Appeals*, 11 LAW & SOC'Y REV. 823 (1977).

To correct the imbalance, Congress consolidated both patentability and enforcement appeals in the CAFC by granting it jurisdiction over appeals from the district courts as well as from the PTO. Hearing both sides of patents controversies, the CAFC appears to have improved the state of the law.[22] The broadened perspective has allowed it to make a new tradeoff. It supervises the PTO's grant of patents closely, but has strengthened the presumption of validity for patents once granted.[23] The overall effect is to increase the law's protection for patentees. Whether or not that is good patent policy, the law is more unified and clear. Hence, Congress is better able to monitor and adjust patent law. A continuing disadvantage of this scheme, however, is that many complicated fact issues, for which specialization would be helpful, are decided in the generalized district courts.[24]

In forming the CAFC, Congress sought to avoid overspecialization and capture by creating "a varied docket spanning a broad range of legal issues."[25] In addition, the court must rotate its judges among panels, to ensure exposure to the entire docket.[26] Along with patents and customs matters, the CAFC hears appeals from the Claims Court, the Court of International Trade, the International Trade Commission, the Merit Systems Protection Board, and certain other agency and district court decisions.[27] The court has received mixed reviews for its performance of these other functions.[28] There is also some nagging jurisdictional uncertainty, although Congress tried to minimize it by assigning the court general review authority for particular trial fora and programs.[29]

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[21] The Supreme Court once remarked: "We have observed a notorious difference between the standards applied by the Patent Office and by the courts." Graham v. John Deere Co., 383 U.S. 1, 18 (1966).

[22] The study by Dreyfuss, *supra* note 19, so concludes.

[23] Id. at 21-26.

[24] Dreyfuss, *supra* note 3, at 411.

[25] H. R. Rep. No. 97-312, 97th Cong., 1st Sess. 19, 31 (1981).

[26] 28 U.S.C. sec. 46.

[27] Adams, *supra* note 9, at 65-67.

[28] Dreyfuss, supra note 3, at 404-06; see, e.g., Vaughn, *Federal Employment Decisions of the Federal Circuit*, 35 AM. U. L. REV. 1037 (1986); Blatt, *The Federal Circuit's 1985 Tax Cases: The Exercise of Equity*, 35 AM. U. L. REV. 1097 (1986).

[29] Adams, *supra* note 9, at 68-75; Note, *An Appraisal of the Court of Appeals for the Federal Circuit*, 57 S. Cal. L. Rev. 301 (1984). For example, even the court's patents jurisdiction remains somewhat incomplete and uncertain, because it does not decide issues arising as defenses in district court. The CIT, which the CAFC reviews, also suffers jurisdictional problems. Cohen,

## B. The Commerce Court

The "Banquo's ghost" at any discussion of specialized courts is the Commerce Court, which had a brief, unhappy life from 1910-13.[30] Citing needs for expertise, expedition, and uniformity, President Taft proposed a court to review decisions of the Interstate Commerce Commission. Even as Congress complied, however, charges emerged that the court would favor the railroads.[31] The court soon found itself in a political maelstrom, without allies--not even the railroads, which were supposed to have captured it. "[T]he Commerce Court entered an environment partial to the Commission and distrustful of courts. With undoubted courage and disinterestedness the Court, heedless of the public temper, promptly began to reverse the Commission and to curb its activity."[32] Although comparison of the court's reversal rate of ICC orders with those of other courts does not support charges of capture by the railroads,[33] perception carried the day and the court passed into history.

The history of the Commerce Court may have conveyed more lessons than were in it. The court existed at a time when specialized judicial review, the particular body of law to be administered, and even administrative regulation were new, evolving, and productive of widespread controversy. Nevertheless, the enduring warning is that no specialized court should be created to oversee a single agency that deals with a single powerful interest group. Even if the court did not, in fact, favor the railroads, the speed with which it lost public confidence is instructive. Indeed, had the court survived, the railroads would have had every incentive to try to capture it.[34]

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*Recent Decisions of the Court of International Trade Relating to Jurisdiction: A Primer and a Critique*, 58 St. John's L. Rev. 700 (1984).

[30] My history of the court is drawn from Dix, *The Death of the Commerce Court: A Study in Institutional Weakness*, 8 Am. J. Leg. Hist. 238 (1964); F. Frankfurter & J. Landis, *supra* note 14, at 153-74; Nathanson, *supra* note 14, at 1004-08; the allusion is Judge Friendly's, *supra* note 14, at 188.

[31] S. Rep. No. 355, 61st Cong., 2d Sess.(1910), 45 Cong. Rec. 1821.

[32] F. Frankfurter & J. Landis, *supra* note 14, at 165.

[33] Dix, supra note 30, at 246 (Commerce Court reversal rate of 41% for ICC; 69% in circuit courts).

[34] In 1894 Attorney General Olney cynically predicted that the ICC could be "of great use to the railroads" if it satisfied popular desire for regulation but was lax in enforcement. He noted that "the older such a commission gets to be, the more inclined it will be found to take the business and railroad view of things." Quoted in M. Josephson, *The Politicos* 526 (1938). Similar hopes or fears could well have been entertained for the court.

### C. The Tax Court

The Tax Court is part of a complex structure for litigating federal tax liability.[35] It began in 1924 as the Board of Tax Appeals, an executive agency designed to have some independence from the Treasury Department.[36] In 1969, it took its present form as an Article I court, titled the United States Tax Court.[37] Repeated attempts to assure the independence of the court have responded to its longstanding reputation as overstaffed with former government lawyers and hence biased against the taxpayer.[38]

A disgruntled taxpayer can resort to any of three trial fora: the specialized Tax Court, the semi-specialized Claims Court, or the generalized district court.[39] All three sit nationwide. The district courts and the Tax Court are reviewed in the regional courts of appeals; the Claims Court, in the CAFC. The result is a highly decentralized system of judicial review. Commentators have heaped abuse on it for many years, with perfect logic and little effect.[40] Not surprisingly, the Internal Revenue Service has long refused to acquiesce in the orders of particular courts of appeals as determining how it should administer its programs nationally.[41] The Tax Court once did so as well, but now follows precedent of the circuit to which appeal lies from a decision.[42]

It seems unlikely that the Tax Court is progovernment today. The government's gross recovery rate is about a third of deficiencies claimed.[43] Moreover, the court hears over 90 percent of the tax cases.[44] Since litigants have the option of avoiding the court if they distrust it, its substantial caseload supports its neutrality.[45] Indeed, the third of the Claims Court docket that consists of tax cases probably reflects taxpayers avoiding adverse precedent in their home circuit, in favor of the CAFC.[46] Any taxpayer victory there can create national precedent, as later cases flow to Claims Court.[47]

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[35] *See generally* Jordan, *supra* note 3, at 749-54. For its history, see H. Dubroff, *The United States Tax Court: An Historical Analysis* (1979).

[36] Revenue Act of 1924, ch. 234, 43 Stat. 253, 336. In 1942 it was renamed the Tax Court of the United States and its members were styled judges. Act of October 21, 1942, sec. 504, 56 Stat. 798, 957.

[37] Pub. L. No. 91-172, §§951-62, 83 Stat. 730.

[38] *See* H. Friendly, *supra* note 14, at 166, reporting this perception.

[39] Kramer, *Jurisdiction Over Civil Tax Cases*, 1990 B.Y.U. L. REV. 443.

[40] See H. Friendly, *supra* note 14, at 161-71 (reviewing the literature and proposing a Court of Tax Appeals).

[41] Estreicher & Revesz, *Nonacquiescence by Federal Administrative Agencies*, 98 YALE L.J. 679, 713-14 (1989).

[42] Golsen v. Comm'r, 54 T.C. 742, 756-58, (1970), *aff'd*, 445 F.2d 985 (10th Cir.), *cert. denied*, 404 U.S. 940 (1971).

[43] United States Tax Court, Annual Report FY 1985, at 11.

[44] Special Project, *An Empirical Study of Intercircuit Conflicts on Federal Income Tax Issues*, 9 VA. TAX REV. 125, 125n.1 (1989).

Tax appeals are not welcomed in the generalist appellate courts. The complexity of the code has for many years daunted federal judges. (Learned Hand lamented that "the words...merely dance before my eyes in a meaningless procession".[48]) As a result, the courts of appeals defer heavily to the Tax Court, notwithstanding congressional efforts to stop the practice.[49]

The specialist approach is equally suited to tax law at both the trial and the appellate level.[50] The intellectual challenge of tax law should benefit a specialized court by attracting able judges. Also, the breadth of the code's impact on society tends to widen the view of the specialist, and to cancel out particular interests in the appointment process.[51]

## D. The Emergency Court of Appeals and the Temporary mergency Court of Appeals.

Like the "temporary" wartime buildings that long graced the Washington Mall,[52] emergency appellate courts have demonstrated their capacity to outlast the crisis that precipitated them. The Emergency Court of Appeals (ECA) was created to exercise exclusive jurisdiction (subject to Supreme Court review) of challenges to price and rent regulations in the era of World War II.[53] Persons aggrieved by actions of the price administrator were required to appeal to the special court or forego review, even in defense of criminal proceedings.[54] Staffed by federal judges designated by the Chief Justice, the court sat in panels throughout the nation. Since regulations remained in effect during the pendency of review, speed and uniformity of result were imperative to the success of the control programs. So was public confidence in the fairness of administration, because national economic controls cannot succeed without extensive voluntary compliance.

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[45] There is a cost to the alternate fora, though. The taxpayer must pay the tax and seek a refund.

[46] Adams, *supra* note 9, at 77.

[47] Project, *supra* note 44, at 130.

[48] Hand, *Thomas Walter Swan*, 57 YALE L.J. 167, 169 (1947).

[49] Project, *supra* note 44, at 132 & n.36, 141 (Tax Court affirmance rate 75%; District Court, 60%).

[50] Kramer, *supra* note 39, at 449-51.

[51] Jordan, *supra* note 3, at 750-51.

[52] For a description, see D. Brinkley, *Washington Goes to War* 119 (1988).

[53] Act of January 30, 1942, ch. 26, 56 Stat. 31; *see generally* Dreyfuss, *supra* note 3, at 393-96; Nathanson, *The Emergency Court of Appeals*, in Office of Price Administration, Problems in Price Control: Legal Phases 1 (1947).

Although the court dealt with a single agency, its programs touched every aspect of society and probably benefited from wartime solidarity.[55] Overall, the court succeeded admirably, sustaining the administrator most of the time but giving complainants enough victories to avoid serious charges of bias.[56] Indeed, Congress kept the court in existence to review various postwar and Korean War control programs; it finally disbanded in 1961.[57]

When economic controls resurfaced in the early 1970s, Congress created a similar court that still exists, the Temporary (sic) Emergency Court of Appeals (TECA).[58] Unlike its predecessor, TECA reviews the district courts; there is also some state court litigation.[59] As general economic controls withered in 1973, the energy crisis arose and TECA took on its current assignment as a reviewer of energy programs.[60] Congress did not pause to consider whether TECA's structure, which preserved access to district courts for the many small businesses affected by national controls, was best suited to a long-term program regulating a single major industry.[61] Moreover, Congress left in place some truncated procedures for agency action that may have fitted an initial crisis, but that caused sharp criticism of the fairness of agency action over the long run.[62] Judicial review risked being both ineffective and duplicative at the same time, because review on a questionable administrative record in the district courts was followed by appeal of right to the courts of appeals.[63]

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[54] Nathanson, *The Emergency Price Control Act of 1942: Administrative Procedure and Judicial Review*, 9 LAW & CONTEMP. PROBS. 60 (1942). The constitutionality of the scheme was upheld in Yakus v. United States, 321 U.S. 414 (1944).

[55] Courts reviewing various aspects of its performance invoked the war powers. Spreecher, *Price Control in the Courts*, 44 COLUM. L. REV. 34 (1944).

[56] *See* Nathanson, *supra* note 14, at 1009-12.

[57] Transcript of Proceedings of the Final Session of the United States Emergency Court of Appeals, 299 F.2d 1 (1961).

[58] Economic Stabilization Act Amendments of 1971, Pub. L. No. 92-210, §2, 85 Stat. 743, 790.

[59] *See* Jordan, *supra* note 3, at 759-62.

[60] Emergency Petroleum Allocation Act of 1973, Pub. L. No. 93-159, §5, 87 Stat. 627, 633; Emergency Natural Gas Act of 1977, Pub. L. No. 95-2, §10(b), 91 Stat. 4.

[61] *See generally* Aman, *Institutionalizing the Energy Crisis: Some Structural and Procedural Lessons*, 65 CORNELL L. REV. 491 (1980).

Not surprisingly, TECA has received more negative reviews than its predecessor. In contrast to the old Commerce Court, which also reviewed single-industry regulation, TECA has been charged with favoring the agency.[64] Perceptions arose that TECA became "caught up in the agency's mission as its reason for being,"[65] in a fundamental confusion of roles. This charge is hard to evaluate, though, because it mimics a more benign influence--the court's awareness of the difficulty of administering highly complex energy programs and a consequent stance of deference.[66] Perhaps such a stance is natural to generalist judges who have enough exposure to particular specialist programs to form some sympathy with those who must administer them.

Because its power is limited to issues arising under particular statutes, TECA has also suffered jurisdictional difficulties.[67] Litigants and the court devote substantial resources to deciding jurisdictional issues. Since TECA issues often accompany unrelated ones, bifurcation of appeals is frequent, and sometimes appeal rights evaporate entirely.[68]

## E. Lessons Learned

Some guidelines for constructing specialized courts emerge from this overview. First, to minimize jurisdictional uncertainty and litigation, subject matter should be chosen for its segregagability from other claims. For example, tax issues usually do not accompany others; energy issues eligible for TECA often do. To avoid bifurcating appeals, litigation should be shunted to the specialized court in its entirety (as occurs with the CAFC)[69] or left in the generalist courts. Too many forum-shopping opportunities attend creation of a new court with jurisdiction over only a portion of an integrated subject matter, such as the old CCPA or the Tax Court. Why endure the general disadvantages of specialization while forfeiting the primary benefit of unification of the law?

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[62] These programs were exempted from the adjudicative requirements of the Administrative Procedure Act. Id. at 496-97, 527-28, 532-36, 571-72; Elkins, *The Temporary Emergency Court of Appeals: A Study in the Abdication of Judicial Responsibility*, 1978 DUKE L.J. 113, 132-36.

[63] Aman, *supra* note 61, at 563-71.

[64] Elkins, *supra* note 62.

[65] Leventhal, *Environmental Decisionmaking and the Role of Courts*, 122 U. PA. L. REV. 509, 515 (1974).

[66] *See* Jordan, *supra* note 3, at 760-61. Another explanation is that both agency and court needed a shakedown period, after which the review relationship is no longer a very distinctive one. Id. at 761-62.

[67] Dreyfuss, *supra* note 3, at 398, 412.

[68] Note, *The Appellate Jurisdiction of the Temporary Emergency Court of Appeals*, 64 MINN. L. REV. 1247, 1256-57 (1980).

Second, the nature of a court's docket should expose the judges to both sides of pertinent controversies, instead of a set of appeals presenting skewed arguments, as in the CCPA. The CAFC, with a wider jurisdiction, sees a full range of related problems in patent law, and must directly balance interests in invention and competition. Also, the consolidation of the cases gives the new court adequate remedial scope to adjust the body of law it administers.

Third, allocations of subject matter should avoid combining generalists and specialists in ways that erode gains from specialization. It makes little sense to have the specialist trial forum of the Tax Court reviewed in the generalist courts of appeals.[70] Similarly, difficulties that the generalist district courts have with patents litigation cannot all be cured by the CAFC, operating under the constraints of appellate review.[71]

Fourth, each stage of judicial review should serve a distinctive function that is best performed by the court employed. Repetitive appellate review in different courts under TECA wastes resources. True, district courts are best able to supplement thin agency records, which have been a problem for TECA, but an obvious cure for that is to provide for adequate administrative process in the first place and to go directly to a court of appeals, with its greater familiarity with substantive issues in administrative programs.[72]

Direct appellate review of final orders suits adjudications involving large amounts in controversy, as in TECA and in many trade, labor, and securities programs. Since high stakes encourage the pursuit of all available appeals, initial district court review becomes duplicative. Moreover, the requirement of exhausting administrative remedies before seeking review allows the agency to perform the winnowing function of the district courts.[73] Efficiency is promoted, because agencies have more latitude than trial courts to conform their procedures to the nature of the issues arising in a particular program, within limits set by the Administrative Procedure Act (APA)[74] and other statutes.

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[69] The CAFC applies the law of the circuit from which a case comes to nonpatent issues found in cases within its jurisdiction. Dreyfuss, *supra* note 3, at 413.

[70] *See generally* Kramer, *supra* note 39.

[71] Dreyfuss, *supra* note 3, at 411-12.

[72] *See* Sargentich, *The Jurisdiction of Federal Courts in Administrative Cases: Developments*, 41 ADMIN. L. REV. 201 (1989).

[73] Currie & Goodman, *supra* note 3, at 6.

Vesting initial review in district courts produces the advantages and disadvantages that attend their greater decentralization and single-judge structure. Private litigants gain more convenient fora; the judiciary conserves two-thirds of the judges needed per case.[75] Perhaps most important, the district courts can be expanded to handle large caseloads without encountering the structural problems that collegial courts present. Hence, Congress often provides district court review of high-volume agency adjudications involving individuals, for example social security disability[76] and immigration[77] programs.

Some administrative cases could be assigned initially to district court, with discretionary review in the court of appeals for the fraction that raise issues of broad importance.[78] Relatively fact-intensive adjudications that usually do not present broad issues of policy and law seem the best candidates.[79] For example, review of Social Security disability determinations currently begins in district court, with appeal of right to circuit court. Most of these cases challenge only the evidentiary support for a determination of no disability. District court provides a relatively convenient and cheap forum for claimants who are typically of modest means. Given the high volume of these cases, existing rights to appeal burden the courts of appeals substantially.

There are several ways to structure discretionary appeals.[80] For court of appeals resources to be conserved, screening appeals requests must be efficient.[81] To eliminate a voluminous source of appeals, assertion of legal error rather than simple fact error by the district judge could be made a precondition to appeal.

Fifth, the Commerce Court and TECA have demonstrated that a court for a single industry or a single agency is in jeopardy of capture by its clientele, or at least debilitating suspicion that it has occurred. In modern contexts where the politics of administration is intense, as it was for railroad regulation early in this century, similar problems might await. Regulation in fields such as environmental quality, nuclear safety, labor relations, and occupational health and safety leads individuals to align themselves with one side or another. For example, law firms do not ordinarily represent clients on both sides of these controversies. A specialized court assigned to any of these fields would provoke wars over appointments and invite cynicism about decisions. The fact that health and safety agencies usually have jurisdiction over many industries is not likely to matter very much. The relevant political dispositions--favoring the environment or economic growth, workers or management--could still be sought in nominees and could be expected to transcend particular industries affected by the agency.

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[74] 5 U.S.C. sec. 551 et seq.

[75] Currie & Goodman, *supra* note 3, at 7-9.

[76] For overview and analysis of this program, see J. Mashaw, Bureaucratic Justice, Managing Social Security Disability Claims (1985).

[77] *See generally* Legomsky, *Forum Choices for the Review of Agency Adjudication: A study of the Immigration Process*, 71 IOWA L. REV. 1297 (1986).

[78] H. Friendly, *supra* note 14, at 176.

[79] The Administrative Conference so recommends; see 1 CFR §305.75-3.

[80] The agency, but not the claimant, could be provided automatic appeal from an adverse district court ruling, in a rough effort to identify appeals likely to raise systemic issues. H. Friendly, *supra* note 14, at 176.

[81] Currie & Goodman, *supra* note 3, at 20. For example, appellants could be required to file a brief jurisdictional statement showing the presence of an issue meriting review.

Even if multiple industries and agencies are gathered in a single broad theme (an environmental court, for example[82]) these fears are justified. So a mix of somewhat unrelated business, as the CAFC now has, appears to be optimum. Such semi-specialization resulted from using generalist judges part time on the ECA, and seems to have aided that court's success. Semi-specialization may allow us not only to dampen appointments abuses, but also to adjust the court's proximity to the private litigants and agencies it hears and its identification with their problems.

Before deriving specific structural prescriptions from this history, though, it is necessary to separate two important variables that preceding discussion has mixed: specialization and independence. A court's jurisdiction can be narrow (Commerce Court), intermediate (CAFC), or broad (U.S. District Court). The tenure of its judges can be unprotected (the pleasure of the President), conditional (a statutory term with removal restrictions), or complete (life tenure). Independence is also a function of the organizational placement of adjudication within an agency or in a separate institution. Although Congress has reserved general federal jurisdiction to the constitutional judiciary, specialized functions of varying breadth have been conferred on adjudicators whose tenure and placement also varies. I now examine the relationship of varying degrees of independence to adjudicative behavior. That discussion grounds analysis in the following section of the role that Article III judges should play in overseeing their fellow adjudicators in order to assure the constitutionality of specialized courts that are not staffed by federal judges.

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[82] An environmental court proposal arose as environmental law burst on the scene in the 1970s. Legislation mandated a study. Pub. L. No. 92-200, sec.9, 86 Stat. 816, 899. *See generally* Whitney, *The Case for Creating A Special Environmental Court System*, 14 WM. & MARY L. REV. 473 (1973). The proposal died after the executive persuasively objected that the jurisdiction of any specialized court should be broad enough to reduce special interest pressure on appointments, to avoid overfamiliarity with the issues and the litigants, and to keep prestige high. President, Acting Through the Attorney General, Report on the Feasibility of Establishing an Environmental Court System (1973); *see also* Hines & Nathanson, *Preliminary Analysis of Environmental Court Proposal Suggested in the Federal Water Pollution Control Act Amendments of 1972*, id.

## III. A Comparison of Federal Adjudicators

Separation of powers analysis usually places particular officers "in" one branch of government or another according to statutory provisions controlling their appointment, responsibilities, salary, and removal, and associated doctrines concerning their amenability to supervision by other officers.[83] Hence, a statement that an adjudicator belongs with the core judiciary of Article III, the "legislative" courts of Article I, or the executive officers of Article II implies a set of preexisting conclusions about the particular attributes of the office in question.

Since federal adjudicators are all appointed by the President or by other executive officers, it is the other variables that determine degrees of independence. The Constitution's focus on life tenure and salary stability as attributes of federal judges suggests that the constitutional stature of other adjudicators depends mostly on their job security.[84]

Certainly the relative security of adjudicators' tenure implies the independence of their judgment, at least when we consider broad differences in protection. A legislative judge with a 15-year term is obviously less vulnerable to outside pressure than a cabinet secretary serving at the pleasure of the President. Difficulty arises, however, in marginal comparisons, for example between long statutory terms and life tenure. Moreover, focusing on formal tenure may obscure the importance of actual practice. Expectations created when a class of adjudicators almost never suffers removal can furnish real independence of judgment. Constitutional distinctions among such similar categories seem evanescent.

Perhaps, then, we must retreat to pure formalism: the Constitution knows two categories, the life-tenured and everyone else, no matter the legal or practical protections available to the unannointed. If so, constitutional requisites for exercise of the judicial power will focus on the roles assigned federal judges and on their relationships with other adjudicators, without regard to particular characteristics of the latter. As we shall see, constitutional analysis has that characteristic. To aid prescriptive analysis, though, we need to survey the legal and practical tenure of adjudicators in the various branches of government, and the differences in behavior that follow differences in their assigned roles.

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[83] P. Shane & H. Bruff, The Law of Presidential Power Ch. 4 (1988).

[84] A cynic might note the obvious appeal to a law professor of any theory that links job prestige to tenure.

## A. Federal Judges

Of course, all federal judges share the same tenure protections, and today no one doubts their independence.[85] I discuss them only to note some differences between district and circuit judges that bear on the assignment to them of administrative review responsibilities.

Single-judge district courts lack the collegial mechanisms by which the courts of appeals seek correct and consistent outcomes.[86] Multi-member panels dampen the idiosyncracy or incompetence of a single judge. Thus, circuit judges have independence from other branches of government, but not decisional independence from one another. Joint decisionmaking benefits both from deliberative interchange and from the need to articulate a legally supportable reason for a decision. Indeed, Congress has sometimes reined in district judges in sensitive areas of public policy by forbidding issuance of injunctions or by requiring three-judge courts. Similarly, the fact that district judges handling constitutional litigation now exercise great (and controversial) power over public bodies such as school boards and jails does not necessarily commend the single-judge model for expanded use in major administrative controversies.[87]

District court decentralization also hinders the formation of a relatively uniform body of law over a large territory.[88] A single judge's decision on an important point of law should not qualify as the "law of the circuit." Inconsistencies result, yet en banc procedures for the district courts remain at a distinctly experimental stage.[89] Hence, although fact-intensive administrative cases can appropriately be assigned to district judges, controversies raising broad issues of law or policy should go to the courts of appeals, where mechanisms to promote legal uniformity are more feasible.[90]

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[85] The controversies early in our national life about impeaching judges on grounds other than commission of serious crimes were settled in favor of the judges. L. Friedman, *A History of American Law* 129-31 (2d ed. 1985).

[86] Currie & Goodman, *supra* note 3, at 10-12.

[87] For an overview and analysis of such litigation, see Chayes, *The Role of the Judge in Public Law Litigation*, 89 HARV. L. REV. 1281 (1976).

[88] Currie & Goodman, *supra* note 3, at 15-16.

[89] Bartels, *United States District Courts* En Banc--*Resolving The Ambiguities*, 73 JUDICATURE 40 (June/July 1989).

The experience of circuit judges may make them better suited than district judges to exercise administrative review, because appellate judges are restrained reviewers of decisions by others, not initial triers of fact. True, district judges should be able to understand and apply the dominant standard for judicial review of formal agency adjudication, the "substantial evidence" test, because the leading Supreme Court case explicitly analogized the reviewing court's role to that of a trial judge deciding what issues to leave with a jury.[91] Still, circuit judges may be more habituated to restraint. A district judge possessed of tools for original factfinding and accustomed to their use may be reluctant to lay them aside.

The courts of appeals follow procedures designed for resolution of issues of law.[92] Their intellectual process is abstract. Their physical location, especially in the D.C. Circuit, is often remote from the impact of administration around the nation. With their high degree of insulation from political pressures, appellate judges may be tempted to cast themselves in the role of guardians of the public interest, against a tendency of bureaucrats to yield to powerful interests.[93] District judges, on the other hand, are factfinders, given to specifics. They are dispersed around the nation, and have closer ties to their communities than do appellate judges. They see administration at the point of impact, and experience its factual context in their courtrooms. Small wonder, then, if there are often differences in perspective about government programs between trial and appellate judges. Most broadly, one might say that district judges are more isolated than circuit judges from the rest of their own branch, yet are less isolated from practical pressures flowing from the litigation they decide.

## B. Legislative Judges

Outside the constitutional judiciary, judges of Article I legislative courts most closely approximate the formal independence of federal judges. Their statutory terms are the longest in government.[94] For example, Claims Court judges have 15-year terms, and are removable by the CAFC only for cause or disability.[95] Tax Court judges also serve for 15 years, and are removable by the President only for cause.[96]

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[90] *See generally* Bruff, *Coordinating Judicial Review in Administrative Law* (forthcoming, UCLA LAW REVIEW).

[91] Universal Camera Corp. v. NLRB, 340 U.S. 474, 477 (1951) (Frankfurter, J.)

[92] Unless otherwise noted, this paragraph reports conclusions of R. Melnick, Regulation and the Courts: The Case of the Clean Air Act, ch. 10 (1983).

[93] *See* Environmental Defense Fund v. Ruckelshaus, 439 F.2d 584, 598 (D.C. Cir. 1971).

Renewable terms risk executive influence on legislative courts, as judges curry favor in hopes of reappointment. For several reasons, though, this risk seems small. First, legislative courts have had low political profiles, so that the prospect of attracting presidential attention is reduced. To be sure, the executive agencies and interest groups that practice before these courts have incentives to monitor judicial performance and to lobby for or against reappointment. To some extent, these influences counterbalance. Perhaps, then, reappointment opportunities serve mostly to dampen obvious bias by legislative judges, of a sort that would provoke someone's intense opposition to continuation. Second, as the foregoing analysis suggests, there has been a practice of nearly automatic reappointment to these courts.[97] Third, the statutory terms span enough of a person's career to diminish the lure of reappointment for all but the youngest appointees. Perhaps hope of promotion to an Article III court causes some judges on legislative courts to curry presidential favor, but judges on lower federal courts also feel the lure of ambition.

Fear of removal cannot cause many sleepless nights for any legislative judge who eschews conduct that would impeach a federal judge. Statutory removal restrictions remain undefined due to a void of litigated removals. And process protections flowing from statute or due process make it unlikely that the authority possessing removal power will think the battle worth the effort.[98] After all, the judge's tenure will eventually expire, even if the judge does not.

When we seek a truly independent adjudicator, institutional separation is nearly as important a tool as a tenure guarantee. Article I judges do reside in separate organizations from the agencies they review, but they remain less independent than are district judges. The vulnerability of specialized adjudication to perceptions of capture is partly due to the effects of a steady diet of subject matter and repeated advocacy from a single source. Thus, even formally separate institutions can come to share values, if the informal links between them are strong enough.

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[94] Except for the Comptroller General, who has a 15-year, nonrenewable term due to the sensitivity of the auditing function. 31 U.S.C. sec. 703(b).

[95] 28 U.S.C. §§172(a), 176. Removal is by a majority of the court, after a hearing.

[96] 26 U.S.C. §7443. Again, opportunity for a hearing is provided.

[97] *See* H. Dubroff, supra note 35, at 212 n.325 (since 1924, only three members of Tax Court and its predecessor have been denied reappointment).

[98] *See* Bowsher v. Synar, 478 U.S. 714, 770 (1986) (White, J., dissenting).

## C. Administrative Adjudicators

There is a fundamental difference between agencies and Article I courts. The latter are true courts, in the sense that they do nothing but adjudicate.[99] They make policy only as all courts do, incidentally to the decision of cases. Agencies, on the other hand, use adjudication along with rulemaking and enforcement processes as tools for the articulation of policy as well as its application to particular parties.[100] This central and distinctive characteristic of the administrative process has led to some structural and legal accommodations that affect adjudicative independence. For agencies have legitimate interests in supervising the performance of their adjudicative processes in ways that might be inappropriate for Article I judges.

Administrative law displays a basic ambivalence about adjudicative neutrality--the benefits of obtaining knowledgeable decisionmaking are gained at the risk of introducing unacceptable levels of bias or interest. This tension between expertise and bias has existed for centuries.[101] Today's accommodation, which is basic to the legitimacy of administrative adjudication, is a set of statutory controls that somewhat resemble judicial structure and procedure.[102] These are: organizational separation of investigative and adjudicative staffs below the level of the heads of an agency, the statutory guarantees of independence that Administrative Law Judges (ALJs) enjoy, and the APA's adjudicative procedures, which are designed to balance informality and fairness.

The Supreme Court has upheld this general arrangement against due process attack.[103] The Court values the protections flowing from separation of functions and procedural guarantees;[104] it tolerates some loss of neutrality as the cost of obtaining the policymaking advantages of combined functions at the top of the agency.[105] Nevertheless, the Court has made it clear that a scheme's particular characteristics can present unacceptable dangers of bias or interest.[106]

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[99] Although some legislative courts have lost Article III status due to "administrative" responsibilities such as reporting claims recommendations to Congress, such functions are incidental to the main duties of these courts, and seem readily separable as well. See note 12 *supra*.

[100] This has long been clear. *See, e.g.*, NLRB v. Bell Aerospace Co., 416 U.S. 267 (1974); SEC v. Chenery Co., 332 U.S. 194 (1947).

[101] *See* Plucknett, *Bonham's Case and Judicial Review*, 40 HARV. L. REV. 30, 34 (1926).

[102] *See* Friendly, *"Some Kind of Hearing,"* 123 U. PA. L. REV. 1267, 1279 (1975): "the further the tribunal is removed from . . . any suspicion of bias, the less may be the need for other procedural safeguards."

[103] Withrow v. Larkin, 421 U.S. 35 (1975)(state board of medical examiners could both investigate and decide charges against a doctor).

[104] *See* Marshall v. Jerrico, Inc., 446 U.S. 238 (1980) (administrator acting as prosecutor could make preliminary assessment of civil penalties when administrative law judge adjudicated the penalties).

Congress has sometimes separated adjudicators entirely from the rest of an agency. This step is feasible for fact-intensive matters such as enforcement proceedings, where adjudication is not central to general policymaking. Moreover, enforcement presents especially sensitive concerns for the fairness of adjudication. This "split enforcement" pattern is prominent in the Department of Labor.[107] It brings charges against those who violate regulations issued under the Occupational Safety and Health Act and the Federal Mine Safety and Health Act before special adjudicatory agencies.[108] After study, the Conference was unable to conclude whether split enforcement better promotes fairness than traditional agency structure.[109] Not surprisingly, there are signs of confusion over policymaking responsiblities.[110] In short, split enforcement is not a cureall for structural tensions in the administrative process.

The degree to which administrative procedure must mimic judicial norms is controlled by due process doctrine. The leading case is *Mathews v. Eldridge*,[111] which upheld the constitutionality of the SSA's procedures for adjudicating disability benefits. The Court called for a utilitarian calculus that weighs the individual's interest in the benefits, the government's interest in informality, and the accuracy of existing procedures.[112] *Eldridge* signaled the Court's awareness of the limits of judicial capacity to improve complex administrative schemes, especially through the imposition of procedures like those of common law courts.[113] Most administrative adjudication is not very vulnerable to constitutional invalidation under the due process clause. Even though the *Eldridge* formulation is indeterminate in application and may be an inappropriate way to approach individual rights,[114] it should suffice to ensure that adjudication is minimally fair.[115]

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[105] *See* Friedman v. Rogers, 440 U.S. 1, 18 (1979) (legislature can draw administrators from an organization sympathetic to the rules to be enforced); (Hortonville Joint School Dist. No. 1 v. Hortonville Education Ass'n), 426 U.S. 482 (1976) (school board could both negotiate with teachers and discharge them for illegal strike after negotiations failed); FTC v. Cement Institute, 333 U.S. 683 (1948) (FTC Commissioners could both testify before Congress regarding the illegality of a practice and later adjudicate the matter).

[106] For example, in Gibson v. Berryhill, 411 U.S. 564 (1973), the Court would not allow a licensing board drawn from one-half of a state's optometrists to decide whether the other half were engaged in unprofessional conduct. *See also* Tumey v. Ohio, 273 U.S. 510 (1927) (town mayor could not adjudicate where fines paid his salary); Ward v. Village of Monroeville, 409 U.S. 57 (1972) (*Tumey* controlled where fines formed a substantial part of municipal revenues).

[107] Other examples are National Transportation Safety Board adjudication of Federal Aviation Administration charges against pilots, 49 U.S.C. §§1422, 1429, and Merit Systems Protection Board adjudication of charges against federal employees. 5 U.S.C. §1201.

[108] The Occupational Safety and Health Review Commission, 29 U.S.C. §661; The Mine Safety and Health Review Commission, 30 U.S.C. §823.

[109] 1 CFR §305.86-5; see Johnson, The Split-Enforcement Model: Some Conclusions from the OSHA and MSHA Experiences, 1986 ACUS 293.

[110] See e.g., Dole v. Occupational Safety and Health Review Comm'n, 891 F.2d 1495 (10th Cir. 1989), *cert. granted*, 110 S.Ct. 3295 (1990) (courts defer to Commission's interpretation of regulation rather than Secretary's).

[111] 424 U.S. 319 (1976).

Within agencies, the trial judges usually have substantial guarantees of independence. This has not always been the case. Passage of the APA in 1946 was spurred partly by complaints that agencies used hearing examiners who lacked objectivity because the agency controlled their tenure.[116] The APA included basic "separation of functions" requirements, forbidding examiners to be supervised by investigative or prosecutorial personnel.[117]

The examiners' modern counterparts, Administrative Law Judges, enjoy statutory tenure protections that justify their loftier title.[118] Agencies select new ALJs from lists of qualified persons maintained by the Office of Personnel Management. OPM, not the employing agency, determines their pay and promotion.[119] They are assigned to cases in rotation, and may not perform duties inconsistent with those of an ALJ.[120] They may be removed only for good cause, as determined by the Merit Systems Protection Board after a hearing.[121] Not surprisingly, agencies that do not use ALJs to make initial decisions endure criticism regarding the fairness of their processes.[122]

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[112] 424 U.S. at 335. The Court thought that SSA procedures were adequately geared to the nature of the participants and issues involved in the program, and it emphasized the need to defer to legislative judgments about optimal procedure.

[113] *See also* Walters v. National Ass'n of Radiation Survivors, 473 U.S. 305 (1985); Board of Curators v. Horowitz, 435 U.S. 78 (1978). In the massive entitlements programs like SSA disability or VA benefits, the government's interest lies in minimizing the sum of process and error costs. The agency is best situated to balance these factors. Moreover, the nonadversary character of administrative hearings is closely related to the substantive goals of these programs, which are paternalistic. *See Walters*, 473 U.S. at 322-23. Administrative procedure is structured to favor the claimant, since the government is not formally represented and new evidence favoring the claim can be introduced at any stage.

[114] *See generally* J. Mashaw, *Due Process in the Administrative State* (1985).

[115] The evolution of administrative law protections for the fairness of adjudication may have helped persuade the Court that juries are not needed to check agency discretion. In Atlas Roofing Co., Inc. v. Occupational Safety and Health Review Comm'n, 430 U.S. 442 (1977), the Court held that the Seventh Amendment does not apply to the assessment of civil penalties in an administrative adjudication. *See also* Tull v. United States, 481 U.S. 412 (1987), holding that the Seventh Amendment does apply to civil penalty actions brought in district court, and distinguishing *Atlas Roofing* as "holding that the Seventh Amendment is not applicable to administrative proceedings." 481 U.S. at 418 n.4.

[116] Lubbers, *Federal Agency Adjudications: Trying to See the Forest and the Trees*, 31 FED. BAR NEWS & J. 383 (1984); Universal Camera Corp. v. NLRB, 340 U.S. 474, 478-79 (1951).

[117] 5 U.S.C. §554 (d)(2); *see generally* Asimow, *When the Curtain Falls: Separation of Functions in the Federal Administrative Agencies*, 81 COLUM. L. REV. 759 (1981).

[118] *See generally* P. Burger, Judges in Search of a Court: Characteristics, Functions and Perceptions of Federal Administrative Law Judges (1984); Lubbers, *Federal Administrative Law*

For many years, ALJs were in little danger of removal by disciplinary proceedings.[123] A recent, sharp upturn in the frequency of removal attempts, though, signals ALJs that their indefinite terms of office are not the practical equivalent of tenure until retirement.[124] Nevertheless, it seems to be generally understood that removal is not proper for reasons that threaten decisional independence of the ALJs, as opposed to misconduct, unethical behavior, or poor work habits (for example, low productivity).[125] Thus, even principles of decisional independence do not free ALJs from all types of administrative control by the agency that employs them.[126] Although the line between independence and administrative control is ultimately evanescent, working

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*Judges: A Focus on Our Invisible Judiciary*, 33 ADMIN. L. REV. 109 (1981); Cass, *Models of Administrative Action*, 72 VA. L. REV. 363, 377-80 (1986).

[119] 5 U.S.C. §5372.

[120] 5 U.S.C. §3105; *see* Ramspeck v. Federal Trial Examiners Conference, 345 U.S. 128, 139-40 (1953) (approving a rotation scheme for examiners that reflected their ability to handle difficult cases).

[121] 5 U.S.C. §7521.

[122] *See* Aman, *supra* note 61, at 587-92 (Department of Energy).

[123] Timony, *Disciplinary Proceedings Against Federal Administrative Law Judges*, 6 W. NEW ENG. L. REV. 807, 807 n.1 (1984) (four proceedings in thirty years).

[124] *See generally* Rosenblum, *Contexts and Contents of "For Good Cause" as Criterion for Removal of Administrative Law Judges: Legal and Policy Factors*, id. 593.

[125] Id.; Timony, *supra* note 123, at 822.

[126] *Ramspeck*, 345 U.S. at 142 (ALJs "were not to be paid, promoted or discharged at the whim or caprice of the agency or for political reasons", but were subject to personnel practices including "reduction in force for lack of funds, . . . decrease of work, and similar reasons"); *accord*, Butz v. Economou, 438 U.S. 478, 514 (1978) (referring to "the importance of preserving the independent judgment" of ALJs); 43 Op. Att'y Gen. 1, 3 (1977) (APA provides "a certain degree of independence of status but not complete independence from administrative control").

definitions often state that ALJs must follow law and policy of the agency, and are free from interference only in their fact judgments in particular cases.[127]

An illustration of the difficulty of defining the appropriate degree of independence for ALJs is provided by a controversy in the SSA's disability benefits program.[128] Turmoil followed SSA's initiation of case disposition goals for individual ALJs, along with a quality assurance program that identified ALJs whose decisions deviated markedly from the average reversal rate of initial benefits denials.[129] Pressure ensued to keep production up and allowance of claims down.[130] The controversy abated somewhat when SSA modified the program to review allowances at random.[131] This episode gave monitoring an unnecessarily bad name because the executive oversight technique seemed designed to skew the outcome of pending adjudications regardless of their merits, thereby invading the realm of fact judgment that has usually been regarded as sacrocsanct.

The SSA controversy reveals the enduring tensions that attend the incompleteness of separation of functions in the agencies.[132] The ALJS are in, but not of, the agencies. Proposals currently circulate to form them into a separate corps, free of residual agency influence.[133] Yet the agencies do retain a legitimate interest in ALJ performance. If an ALJ systematically diverges from the agency's view of its statute or its policies on methods of fact determination, the agency bears a responsibility to try to avert the resulting inequality or illegality. The federal courts lack the perspective to monitor and correct systemic deficiencies in programs like disability benefits. The agency has the capacity to gather the necessary information and to send signals that will register, both through general policymaking and through managerial monitoring.

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[127] Rosenblum, *supra* note 124, at 617; *see also* Administrative Conference of the United States, Recommendation 78-2, 1 CFR sec. 305.78-2 ("Maintaining the administrative law judges' decisional independence does not preclude the articulation of appropriate productivity norms or efforts to secure adherence to previously enunciated standards and policies"); M. Ruhlen, Manual for Administrative Law Judges 79 (rev. ed. 1982) ("It is the Judge's duty to decide all cases in accordance with agency policy"); *see* Campbell v. Heckler, 103 S.Ct. 1952 (1983) (upholding particular HHS instructions to ALJs).

[128] *See generally* Levy, *Social Security Disability Determinations: Recommendations for Reform*, 1990 B.Y.U. L. REV. 461, 478-502.; *see also* W.C. v. Bowen, 807 F.2d 1502 (9th Cir. 1987); Nash v. Bowen, 869 F.2d 675 (2d Cir. 1989).

[129] *See generally* Note, *Preserving the Judicial Independence of Federal Administrative Law Judges: Are Existing Protections Sufficient?*, 4 J. LAW & POLITICS 207, 217-22 (1987); Note, *Administrative Law Judges, Performance Evaluation, and Production Standards: Judicial Independence versus Employee Accountability*, 54 GEO. WASH. L. REV. 591 (1986).

[130] Sen. Subcomm. on Oversight of Government Management, 98th Cong., 1st Sess., The Role of the Administrative Law Judge in the Title II Social Security Disability Insurance Program 36 (Comm. Print 1983).

[131] Ass'n of Administrative Law Judges v. Heckler, 594 F.Supp. 1132 (D.D.C. 1984).

[132] *See* Mashaw, *supra* note 76, at 41-44. Professor Asimow, *supra* note 117, at 759, notes that in 1941 Professor Nathanson could refer to separation of functions controversy as a "hardy perennial." By now, it is an oak.

[133] *See generally* Symposium, *Administrative Law Judges*, 6 W. NEW ENG. L. REV. 587 (1984); Lubbers, *A Unified Corps of ALJs: A Proposal to Test the Idea at the Federal Level*, 65 JUDICATURE 266 (1981).

An agency's final decision is often vested in its head officers.[134] At this level, sharp differences in formal tenure appear. Members of the independent regulatory agencies serve substantial terms (shorter, though, than Article I judges) and are usually removable by the President only for cause.[135] Presidents rarely remove these commissioners,[136] although a whiff of scandal and a threat of removal force an occasional resignation. Three potent factors deter active presidential supervision and removal. First, the Supreme Court has made broad statements supporting the independence of these officers from presidential supervision.[137] Second, Congress is quite jealous of its hegemony over the independent agencies, and can be expected to react strongly to any executive poaching.[138] Third, removal of an officer who adjudicates can offend due process and statutory restrictions on outside interference with decisions in particular cases.[139]

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[134] Above the ALJs, some agencies have intermediate appellate review boards. Cass, *Allocation of Authority Within Bureaucracies: Empirical Evidence and Normative Analysis*, 66 B.U. L. REV. 1 (1986); Freedman, *Review Boards in the Administrative Process*, 117 U. PA. L. REV. 546 (1969).

[135] E.g., 15 U.S.C. §41 (Federal Trade Commissioner serves seven years and is removable by President only for "inefficiency, neglect of duty, or malfeasance in office"). The constitutionality of this provision, on which many later ones are based, was upheld by the Supreme Court in Humphrey's Executor v. United States, 295 U.S. 602 (1935).

[136] For an exception, see Berry v. Reagan, 32 Empl. Prac. Dec. (CCH) para. 33,898 (D.D.C.), *vacated as moot,* 732 F. 2d 949 (D.C. Cir. 1983).

[137] *Humphrey's Executor*, 295 U.S. at 628-30. See Scalia, *Historical Anomalies in Administrative Law*, Supreme Court Historical Society Yearbook 1985, at 110, remarking that the case "continues to induce the Executive to leave the policy control of the independent agencies to congressional committees, and fastidiously to avoid any appearance of influence in those entities."

[138] For an example of congressional attitudes about agency independence,see Sen. Comm. on Governmental Affairs, 5 Study on Federal Regulation, Regulatory Organization, 95th Cong., 1st Sess. (1977).

[139] *See* Pillsbury Co. v. FTC, 354 F.2d 952 (5th Cir. 1966) (condemning congressional pressure on a pending adjudication); 5 U.S.C. sec. 557(d).

Cabinet officers, who sometimes finally decide adjudicative matters,[140] serve at the pleasure of the President. Nevertheless, as a consequence of the third factor above, it is generally understood that presidential supervision of execution should steer clear of interference in adjudications, no matter who performs them.[141] Nor is presidential interest in and dislike of a particular decision likely to rise to the point of firing a subordinate whose performance is otherwise satisfactory. Indeed, cabinet officers having adjudicative responsibilities often find it wise to delegate them to less politically involved subordinates,[142] thereby divesting themselves of control over the decisions unless and until the delegation is rescinded.[143] Unlike ALJs, these officers may enjoy no formal tenure protections,[144] but there is often de facto job security.[145]

Thus, all of our nonconstitutional judges can decide cases without serious fear of removal for a particular decision. Perhaps, though, the Article I officers derive somewhat greater independence than ALJs or independent agency commissioners enjoy, due to the longer assured term or the title of judge.

Still, there is a basic difference in the vulnerability of decisions of adjudicators to reversal by higher authority. The courts of appeals review findings of Article I judges as they do those of district judges, under the "clearly erroneous" standard.[146] In administrative law, officers reviewing ALJ findings are not constrained by any deferential standard. Instead, courts review the *agency's* final decision for substantial evidence on the whole record, and grant the ALJ's contribution only "such probative force as it intrinsically commands."[147] The substantial evidence and clearly erroneous tests are approximately equivalent; if anything, courts are supposed to defer somewhat more to agencies than to district judges.[148] Hence, it is the agency's final deciders and not its ALJs whose decisions are difficult to displace.

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[140] E.g., United States v. Morgan, 313 U.S. 409 (1941) (Secretary of Agriculture).

[141] ABA Commission on Law & The Economy, Federal Regulation: Roads to Reform-- (1979) (recommending presidential authority to intervene in agency decisions except for adjudications).

[142] For example, the Environmental Protection Agency has a judicial officer.

[143] United States v. Nixon, 418 U.S. 683 (1974).

[144] See e.g., Kalaris v. Donovan, 697 F.2d 376 (D.C. Cir. 1983) (members of Department of Labor's Benefits Review Board lack protected tenure).

[145] *See* Koch & Koplow, *The Fourth Bite at the Apple: A Study of the Operation and Utility of the Social Security Administration's Appeals Council*, 17 FLA. ST. U. L. REV. 199, 269 (1990).

[146] Rule 52(a), Fed.R.Civ. P. 26 U.S.C. §7482 requires the courts of appeals to review Tax Court decisions in the "same manner" as those of district courts.

[147] Universal Camera Corp. v. NLRB, 340 U.S. 474, 496 (1951).

Some differences in behavior between Article I trial judges and ALJs stem from differences in their assigned roles. Although the common law trial model probably fits Article I judges about as well as it does district judges, ALJs often depart from the norms of the adversary system. First, in their traditional service in economic regulation, ALJs have freely articulated policy proposals for agency consideration. Second, their role has evolved substantially:[149]

> [I]t is inescapable that the administrative law judge in today's Federal Government has become less an organizer and initial decider of regulatory policy issues and more the (often-final) dispenser of disability benefits or arbiter of civil money penalties--cases where factfinding, demeanor evidence, fairness and speed are hallmarks, and policy issues absent or submerged.

Moreover, this more usual modern service in fact-intensive adjudication is often defined nonadversarially. In the mass benefits programs such as SSA disability, the government is not formally represented and the ALJs are charged with an active role in developing the claimant's case.[150] The Supreme Court, upholding the constitutionality of a statutory provision that effectively excluded lawyers from the Veterans Administration claims process, stressed the nonadversarial, inquisitorial, and paternalistic aspects of the program, which the introduction of lawyers might disrupt.[151]

Even when Article I judges and ALJs have superficially similar responsibilities, there may be real behavioral differences. Agencies make policy not only through substantive regulations that have the force of law, but also through interpretive regulations and other informal policy statements that have an uncertain capacity to bind adjudicators.[152] It may be that ALJs treat the interpretive and informal policies of their employing agency with more deference than an Article I judge would accord to the policy of a formally separate agency. For example, IRS interpretive regulations probably receive more independent scrutiny in the Tax Court than do similar SSA policy statements before their ALJs.

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[148] Ethyl Corp. v. EPA, 541 F.2d 1, 34-35 n.74 (D.C. Cir. 1976), *cert. denied*, 426 U.S. 941.

[149] Lubbers, *supra* note 116, at 385. *See also* Pops, *The Judicialization of Federal Administrative Law Judges: Implications for Policymaking*, 81 W.VA. L. REV. 169 (1979).

[150] See, e.g., Heckler v. Campbell, 461 U.S. 458 , 470-76 (1983) (Brennan and Marshall, JJ., concurring) (complaining about sufficiency of ALJ's discharge of "duty of inquiry").

[151] Walters v. National Ass'n of Radiation Survivors, 473 U.S. 305 (1985).

More generally, those who work within an agency are subject to a multitude of open or subtle socializing pressures that do not reach a separate institution.[153] For example, an increase or decrease in the staff assigned to a task may signal its importance to agency personnel, or headquarters may grumble about the number of claims being honored. These pressures may be more important than formally stated policy, but they may be very difficult to detect and monitor from the outside. This does not mean that they are necessarily pernicious--for example, a tradition of devotion to high quality public service is to be hoped, if not expected, of every agency.

Overall, the job security of federal adjudicators correlates with their independence from the policy preferences of agencies. Federal judges rank the highest in both variables; legislative judges, in the middle; agency adjudicators, the lowest. Although these were mostly variations in degree, they are worth considering when designing institutions. Before proceeding to some recommendations for that task, I pause to review some governing constitutional considerations.

## IV. Notes on Constitutional Architecture 154

Everyone agrees that congressional power to allocate adjudicative functions among legislative courts, administrative agencies, and constitutional courts is broad. No clear limits have emerged; the Supreme Court cases are notoriously obscure. This is not the place to grapple with the tar baby, but it is necessary to outline some fundamentals about the use of specialized courts.

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[152] Chrysler Corp. v. Brown, 441 U.S. 281, 301-03 (1979) (explaining the difference between substantive and interpretive regulations, and declining to defer to the latter); *see also* American Bus Ass'n v. United States, 627 F.2d 525 (D.C. Cir. 1980) (delineating the murky boundary between these categories of regulation); Koch, *Public Procedures for the Promulgation of Interpretive Rules and General Statements of Policy*, 64 GEO. L.J. 1047 (1976).

[153] See J. Mashaw, *supra* note 76, ch. 7; Koch & Koplow, *supra* note 145, at 239.

[154] The title of this section is a bow to a fine article by the late Paul Bator, *The Constitution as Architecture: Legislative and Administrative Courts Under Article III*, 65 IND. L.J. 233 (1990). The article appears in *Symposium, Paul Bator: Legislative and Administrative Courts Under Article III*, 65 IND. L.J. Number 2 (1990). See also Fallon, *Of Legislative Courts, Administrative Agencies, and Article III*, 101 Harv. L. Rev. 915 (1988); Sager, *Supreme Court, 1980 Term: Foreword--Constitutional Limitations on Congress' Authority to Regulate the Jurisdiction of the Federal Courts*, 95 HARV. L. REV. 17 (1981).

A dilemma confounds the constitutional analysis. Separation of powers principles suggest that some "inherent" or "core" functions may not be taken from the constitutional courts. Identifying these, however, is no easy matter. For we cannot simply require that all adjudicative functions be placed in the federal courts and not elsewhere.[155] Many adjudicative activities are "executive" in the sense that they may or must be placed in that branch.[156] For example, the first Congress enacted statutes vesting determinations of veterans' benefits and customs duties in executive officers.[157] Thus, adjudication has been both a judicial and an executive function from the outset.[158]

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[155] The Court has inadvertently demonstrated why a simple formalist distinction will not suffice for separation of powers purposes, by remarking that "[i]nterpreting a law enacted by Congress to implement the legislative mandate is the very essence of 'execution' of the law." Bowsher v. Synar, 478 U.S. 714, 733 (1986). Yet this definition also describes much of what the federal courts do. *See* INS v. Chadha, 462 U.S. 919, 963-67 (1983) (Powell, J., concurring) (characterizing congressional supervision of agency action performed by adjudication as unconstitutional intervention in a judicial function). *See Bowsher*, 478 U.S. at 748-53 (Stevens, J., concurring).

[156] Bator, *supra* note 154, at 263-65. Examples include many of the President's exercises of law-applying judgment pursuant to statutes or the Constitution. See Bruff, *Judicial Review and the President's Statutory Powers,* 68 VA. L. REV. 1, 17-18 (1982). True, most adjudication that occurs in administrative agencies and legislative courts could be assigned to the federal courts under the federal question jurisdiction. To do so, however, could create a vastly bloated judiciary and an equally shrunken executive.

[157] Fallon, *supra* note 154, at 919. Perhaps Congress thought that these claims against the government were otherwise barred by sovereign immunity, and were therefore fit for executive determination. The common law doctrine of sovereign immunity was not clearly received into our law until the 19th century, however. See P. Shane & H. Bruff, *supra* note 83, at 43.

[158] Chief Justice Marshall understood this. In *Ex parte* Randolph, 20 F.Cas. 242, 254 (C.C.D. Va. 1833) (No. 11,558), he considered the validity of a warrant issued by a Treasury officer who had made adjudicative determinations: "That [setting the amount of a duty] may be, in an enlarged sense, a judicial act, must be admitted....In this sense the act of the President in calling out the militia under [a statute] or of a commissioner who makes a certificate for the extradition of a criminal, under a treaty, is judicial." Perhaps perceiving--and wishing to obscure--this point, the Supreme Court soon approved the placement of various adjudicative functions in the executive by labelling them "executive" or "administrative". Young, *Public Rights and the Federal Judicial Power: From* Murray's Lessee *Through* Crowell *to* Schor, 35 BUFF. L. REV. 765, 795-98 (1986). For example, the Court upheld the Secretary of the Navy's denial of death benefits to the widow of Admiral Decatur. Decatur v. Paulding, 39 U.S. (14 Pet.) 497 (1840).

To further complicate matters, a theory of legislative courts arose in *American Insurance Co. v. Canter.*[159] Chief Justice Marshall held that the creation of Florida's territorial court, whose judges had 4-year terms, was a valid exercise of the legislative powers of Congress, and was therefore freed of Article III requirements. Marshall's sweeping rationale has suffered withering criticism.[160] No matter, Marshall's basic notion that Congress could rely on its Article I powers to create adjudicative bodies has endured. Indeed, it is easy to see why some place for legislative courts would be found in the Constitution, and equally easy to see why setting limits would prove vexing. By the time *Canter* was decided, overlap between judicial and executive functions was already visible. If executive bodies having few or none of the traditional tenure and process safeguards of the courts could adjudicate, why not bodies having *some* of those safeguards? Moreover, the diversity of the functions entrusted to government suggests a need for flexible institutional structure.[161]

Yet once these general concessions are made, it becomes very hard to know where to stop.[162] All federal statutes must rest on a grant of power somewhere in Article I--may all implementation of these powers therefore be committed to Article I courts? And at what point does the formation of legislative courts intrude not on judicial but on *executive* authority, by infringing the President's power to supervise execution?[163]

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[159] 26 U.S. (1 Pet.) 511, 546 (1828).

[160] C Wright, *The Law of Federal Courts* 41-42 (4th ed. 1983); M. Redish, *Federal Jurisdiction: Tensions in the Allocation of Judicial Power* 36-39 (1980).

[161] For example, courts-martial, traditionally viewed as legislative courts, United States ex rel. Toth v. Quarles, 350 U.S. 11 (1955), reflect both special characteristics of the military and special constitutional considerations flowing from the President's role as Commander in Chief.

[162] A modern case that exemplifies the persisting confusion is Glidden Co. v. Zdanok, 370 U.S. 530 (1962). The Court held that the Court of Claims and the Court of Customs and Patent Appeals, which had previously been held to be legislative courts,Williams v. United States, 289 U.S. 553 (1933); Ex parte Bakelite Corp., 279 U.S. 438 (1929), were Article III courts. But no majority could be mustered for a rationale. Three justices thought that they had always been constitutional courts; two, that they had been so since Congress had so designated them; two, that they remained legislative courts. Justice Harlan's plurality opinion suggested that Congress might need special justification to create legislative courts, "When the peculiar reasons justifying investiture of judges with limited tenure have not been present, the *Canter* holding has not been deemed controlling", 370 U.S. at 548, yet assumed that no "inherently" judicial business was involved in this case.

[163] Consider the independent agencies, which are sometimes characterized as legislative courts as though that diminishes concern for their legitimacy. Sommer, *Independent Agencies as Article One Tribunals: Foundations of a Theory of Agency Independence*, 39 ADMIN. L. REV. 83 (1987).

The Supreme Court's traditional formulation of the limit to congressional power is the doctrine that "public rights" can be decided outside constitutional courts.[164] In practice, the doctrine has involved more labeling than analysis, but at least it has sanctioned the creation of the administrative state.[165] *Crowell v. Benson*[166] established the modern theoretical foundation for delegating adjudicative power to administrative agencies.[167] The Court rejected a due process assault on administrative factfinding, because judicial review allowed the courts to decide issues of law (including the presence of substantial evidence for the agency's findings).[168] The basic strategy of *Crowell*, then, was to allow administrative adjudication as long as vital judicial controls were present.[169] Congress was free to allocate initial authority to tribunals that might be temporary, specialized, and informal, without staffing them with federal judges, as long as appropriate appellate jurisdiction remained in the federal courts.[170]

*Crowell's* theoretical compromise still holds sway, although the Court has struggled in recent years to find the limits of congressional power to convert traditional judicial functions into public rights to be adjudicated by agencies or legislative courts.[171] In *Commodity Futures Trading Com'n v. Schor*,[172] the Court allowed agency adjudicators to entertain state law counterclaims in reparation proceedings, in which disgruntled customers seek redress for brokers' violations of statutes or regulations. Justice O'Connor's majority opinion asked whether the new forum exercised the "range of jurisdiction and powers normally vested only in article III courts," and whether the latter retained the "essential attributes of judicial power."[173] Only the jurisdiction over counterclaims differed from the usual agency model.[174] Thus, *Schor* suggests that agencies may resolve even a traditional state-law claim that is closely related to a federal issue within their jurisdiction.[175]

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[164] It originated in Murray's Lessee v. Hoboken Land & Improvement Co., 59 U.S. (18 How.) 272, 284 (1856), which upheld a summary procedure for the government to recoup its funds from its customs collectors. After opining that Congress could not withdraw from the courts "any matter which, from its nature" is judicial, the Court noted that: "At the same time there are matters, involving public rights, which may be presented in such form that the judicial power is capable of acting on them, and which are susceptible of judicial determination, but which congress may or may not bring within the cognizance of the courts of the United States, as it may deem proper." The Court's opaqueness probably stemmed from its recognition of the overlap of judicial and executive functions, which it drew from Marshall's earlier insight, 59 U.S. (18 How.) at 280.

[165] Strauss, *The Place of Agencies in Government: Separation of Powers and the Fourth Branch*, 84 COLUM. L. REV. 573 (1984); Bruff, *Public Programs, Private Deciders: The Constitutionality of Arbitration in Federal Programs*, 67 TEX. L. REV. 441, 464-77 (1989).

[166] 285 U.S. 22 (1932).

[167] Congress had created a worker's compensation scheme for longshoremen. An agency was authorized to decide claims under formal adjudicative procedures resembling those later codified in the APA (an examiner was to conduct evidentiary hearings on a record). 285 U.S. at 47-48.

[168] The Court held, however, that courts must perform independent review of issues of constitutional or jurisdictional fact going to the power of the agency in the premises, such as whether an accident had occurred on the navigable waters. Id. at 63-64. The doctrines of constitutional and jurisdictional fact have since fallen into desuetude. Monaghan, *Constitutional Fact Review*, 85 COLUM. L. REV. 229 (1985).

[169] *See* Hart, *The Power of Congress to Limit the Jurisdiction of Federal Courts: An Exercise in Dialectic*, 66 HARV. L. REV. 1362 (1953).

[170] Bator, *supra* note 154, at 266-68.

There are several justifications for placing adjudicative functions in the executive. First, like common law courts, agencies use adjudication to form policy.[176] Therefore, the Court's doctrine of deference to an agency's judgments of law and policy extends to the adjudicative context.[177] Nevertheless, the policymaking component of agency adjudication varies across a wide spectrum. For example, compare the frank policy orientation of the Federal Communications Commission's hearings on renewal of broadcast licenses[178] with the narrow factual focus of a Social Security Administration determination of an individual's disability.[179]

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[171] See sources cited *supra* notes 154 & 165; *see also* Redish, *Legislative Courts, Administrative Agencies, and the Northern Pipeline Decision*, 1983 DUKE L.J. 197.

[172] 478 U.S. 833 (1986).

[173] Justices Brennan and Marshall, dissenting, argued that the majority was allowing the undue dilution of judicial authority in service of legislative convenience.

[174] The CFTC's jurisdiction was specialized; its enforcement powers were limited; its orders received normal judicial review. The Court saw no reason to deny agencies all pendent jurisdiction.

[175] In Granfinanciera. S.A. v. Nordberg, 109 S.Ct. 2782 (1989), the Court held that a person who had not submitted a claim against a bankruptcy estate had a right to a jury trial when sued by the bankruptcy trustee to recover an allegedly fraudulent money transfer. Justice Brennan's majority opinion stressed that "[i]f a statutory right is not closely intertwined with a federal regulatory program Congress has power to enact, and if that right neither belongs to nor exists against the Federal Government, then it must be adjudicated by an Article III court." 109 S.Ct. at 2797. The trustee's claim was not intertwined with a regulatory program as were those in *Schor*; it asserted a "private right". Justice Scalia, concurring, argued that public rights were based on sovereign immunity and were therefore restricted to claims by or against the government. Dissenting opinions by Justices White, Blackmun, and O'Connor feared a retreat from *Atlas Roofing* and *Schor*, and thought that juries were out of place in the integrated scheme of bankruptcy law.

[176] *See, e.g.*, SEC v. Chenery Corp., 318 U.S. 80 (1943).

[177] E.g., NLRB v. Hearst Publications, Inc., 322 U.S. 111 (1944).

When adjudication focuses on application of a known legal criterion to disputed facts,[180] the justification for transferring it out of federal court does not evaporate. A traditional justification for creating agencies has been to obtain speedy and informal adjudication. Congressional judgments about the appropriateness of administrative rather than judicial process have long been entitled to judicial weight.[181] Moreover, shunting fact-intensive adjudications to agencies or to legislative courts can leave the federal courts free for their central responsibilities of interpreting the Constitution and statutes.

Agencies and Article I courts decide issues of constitutionality, law, and fact. Of course, these categories blur at the margin, but they aid analysis.[182] Which of these issues must an Article III court review, and with what intensity?[183] The Supreme Court has never decided whether the due process clause allows Congress to preclude review of an administrative decision completely.[184] To avoid reaching this troubling separation of powers issue, courts often read statutes that appear to preclude all review to permit at least constitutional inquiries.[185]

In administrative law, statutes usually authorize rather than forbid judicial review. Even when review is authorized, however, courts decline to review some executive functions, including some adjudicative ones.[186] Broad statements about the necessity for preserving judicial review of administrative action must be qualified by recognition that not all executive activity is suitable for review.[187] The Court has emphasized, however, that nonreviewability is "a very narrow exception", applicable only when "statutes are drawn in such broad terms that . . . there is no law to apply."[188] Nonreviewable functions often feature broad agency discretion, needs for expertise, informality, and expedition, a large volume of potentially appealable actions, and the presence of other methods of preventing abuses of discretion.[189] To the extent that an administrative program possesses these characteristics, courts are likely to honor statutory limits on review even if they would not invoke nonreviewability doctrine on their own.

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[178] *See generally* Robinson, *The Federal Communications Commission: An Essay on Regulatory Watchdogs,* 64 VA. L. REV. 169 (1978).

[179] E.g., Heckler v. Campbell, 461 U.S. 458 (1983).

[180] For a helpful summary of administrative law distinctions between issues of fact and law, see NLRB v. Marcus Trucking Co., 286 F.2d 583, 590-91 (2d Cir. 1961) (Friendly, J.).

[181] E.g., Walters v. Nat'l Ass'n of Radiation Survivors, 473 U.S. 305 (1985).

[182] *See* Levin, *Identifying Questions of Law in Administrative Law*, 74 GEO. L. J. 1, 9-14 (1985).

[183] *Crowell* contemplated judicial review of all three, with independent judgment or the limited deference that characterizes substantial evidence review of fact issues. Yet we must accommodate both subsequent doctrinal developments and a competing tradition that expected little or no judicial review of public rights cases. For the latter, see Strauss, *supra* note 165, at 632: "the whole point of the 'public rights' analysis" has often been that "*no judicial involvement at all* was required--executive determination alone would suffice."

[184] Sager, *supra* note 154.

[185] E.g., Johnson v. Robison, 415 U.S. 361 (1974); Bartlett v. Bowen, 816 F.2d 695 (D.C. Cir.), *reinstated and motion for rehearing en banc denied*, 824 F.2d 1240 (1987) (limitation on judicial review in Medicare Act does not apply to constitutional challenges to Act).

[186] E.g., Heckler v. Chaney, 470 U.S. 821 (1985).

Congress should not restrict federal court review of constitutional issues.[190] Tenure and salary protections for federal judges were meant to insulate them from pressure emanating from Congress and the executive. They are ideally situated to check aggrandizement by either of the political branches,[191] and to protect individual rights. And surely there is no better use for their limited time than resolution of these issues.

Judicial review of statutory issues should also be preserved.[192] As with constitutional questions, the law-declaring role of a generalist and independent judiciary is paramount. Administrative law contains numerous safeguards against capture of agencies by interest groups; judicial review of questions of law is one of the most important.[193] Moreover, agencies have significant incentives to aggrandize their own power through aggressive statutory interpretation.[194] Fortunately, outright congressional preclusion of review is rare;[195] it is also unnecessary. Judicial review of an agency's statutory interpretations can be deferential enough to avoid unwarranted interference with administrative discretion.[196]

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[187] Indeed, the public rights doctrine arose in an era of quite limited review of executive action. Young, *supra* note 158, at 795-804.

[188] Citizens to Preserve Overton Park v. Volpe, 401 U.S. 402, 410 (1971), quoting the APA's legislative history, S. Rep. No. 752, 79th Cong., 1st Sess. 26 (1945).

[189] *See generally* Saferstein, *Nonreviewability: A Functional Analysis of "Committed to Agency Discretion,"* 82 HARV. L. REV. 366 (1968).

[190] Fallon, *supra* note 154, at 975-76.

[191] Strauss, *Formal and Functional Approaches to Separation-of-Powers Questions--A Foolish Inconsistency?*, 72 CORNELL L. REV. 488, 517-26 (1987); Sunstein, *Constitutionalism After the New Deal*, 101 HARV. L. REV. 421, 448-50, 467-68 (1987).

[192] Fallon, *supra* note 154, at 976-82.

[193] Bruff, *Legislative Formality, Administrative Rationality*, 63 TEX. L. REV. 207 (1984).

[194] Bruff, *Presidential Management of Agency Rulemaking*, 57 GEO. WASH. L. REV. 533, 552-54 (1989); Breyer, *Judicial Review of Questions of Law and Policy*, 38 ADMIN. L. REV. 363, 371 (1986).

[195] A prominent historical example, actions of the Veterans Administration, has been eliminated by legislation that I discuss *infra* part V.A. *See generally* Rabin, *Preclusion of Judicial Review in the Processing of Claims for Veterans' Benefits: A Preliminary Analysis*, 27 STAN. L. REV. 905 (1975).

It is enough for constitutional courts to scrutinize the legality of generally applicable administrative policies, procedures, and regulations, without delving into their application to particular facts.[197] Here we depart from *Crowell*, but codify existing judicial tendencies to reach issues that concern the overall structure and validity of a statutory scheme, but to honor preclusions of fact review.[198] Thus, the Supreme Court reviewed a scheme for arbitration of certain Medicare claims, and decided that it comported with due process.[199] A companion case, *United States v. Erika, Inc.*,[200] found that no judicial review of particular awards was authorized. The Court noted that the preclusion did not extend to initial determinations of entitlement to participate in the Medicare program, but only to the processing of individual claims. So limited, the preclusion prevented "the overloading of the courts with trivial matters."[201] The Court subsequently held that the preclusion did not extend to statutory issues concerning the overall method by which claims are to be computed, as opposed to particular determinations under the general criteria.[202]

There are two principal reasons for restricting judicial review of facts. First, "retail" review of fact determinations in particular cases can absorb vastly more judicial resources than "wholesale" review of overall policy and procedure. Yet if individual rights must suffer, we should be most reluctant to invoke this ground alone.[203] Here we must realize that "minor" administrative cases often receive only summary review in federal court, whatever their importance to affected individuals.[204] Thus, raw statistics on review caseloads can overstate both the actual burden on the courts and the contribution of the constitutional judiciary to review efforts.[205]

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[196] Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984); *see generally* Anthony, *Which Agency Interpretations Should Bind Citizens and Courts?*, 7 YALE J. ON REG. 1 (1990).

[197] Note, *Congressional Preclusion of Judicial Review of Federal Benefit Disbursement: Reasserting Separation of Powers*, 97 HARV. L. REV. 778, 792-92 (1984) (reporting that the courts have so behaved).

[198] E.g., Lindahl v. Office of Personnel Management, 470 U.S. 768 (1985). The Court interpreted a broad preclusion provision of the Civil Service Retirement Act, 5 U.S.C. §8347(c), to allow review of procedural irregularity, statutory misconstruction, or other error "'going to the heart of the administrative determination'", but not fact review. 470 U.S. at 779-81.

[199] Schweiker v. McClure, 456 U.S. 188 (1982).

[200] 456 U.S. 201 (1982).

[201] 456 U.S. at 210 n.13, quoting the legislative history. The Court did not, however, reach issues concerning any constitutional right to review. Id. at 211 n.14.

[202] Bowen v. Michigan Academy of Family Physicians, 476 U.S. 667 (1986); *see also* McNary v. Haitian Refugee Center, Inc., 111 S.Ct. 888 (1991).

[203] *See* Strauss, *Article III Courts and the Constitutional Structure*, 65 IND. L. J. 307, 309 (1990)("Why isn't the impartial decision of specific cases the essence of the judicial function?").

Second, stopping fact review short of federal court may actually improve the fairness and consistency of factfinding in some administrative programs. The SSA's disability benefits adjudications provide a prominent example. Internal SSA mechanisms are better able to promote fairness and consistency of outcome than are decentralized district courts reviewing episodically.[206] The agency's internal Appeals Council, which reviews ALJ decisions, has the potential to monitor adjudications systematically and to translate needed correctives into binding policy.[207]

This does not mean, however, that agency factfinding should be final. Legislative courts may provide acceptable substitutes for the constitutional courts, bearing institutional benefits for both the agencies they review and the courts they partially displace. I turn to that prospect.

## V. A Legislative Court for Initial Review of Selected Agency Programs

A brief review of my major conclusions so far may aid consideration of the specific recommendations to follow. Part I described the benefits of specialized adjudication as caseload relief for other courts, expert and efficient case disposition, institutional flexibility, and promotion of a uniform body of law. The costs were lower prestige, distortion of the appointments process, and loss of appropriate perspective on administrative problems.

Part II concluded that the history of these courts showed needs for jurisdictional clarity, exposure to both sides of controversies, comprehensive control of subject matter, attention to the respective contributions of specialists and generalists in any mixed scheme, allocation of review functions to trial or appellate courts according to their abilities, and the need to avoid narrow specialization, with its dangers of capture.

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[204] *See* Koch & Koplow, *supra* note 145, at 225 n.142 (SSA disability cases in district courts routinely sent to magistrates for recommended decision).

[205] *See* Flanders, *What Do the Federal Courts Do? A Research Note*, 5 REV. OF LITIGATION 199, 206 (1986) (SSA disability cases 15 to 20% of federal court filings, but perhaps only 2% of actual workload).

[206] J. Mashaw, *supra* note 76, at 187-93, 213-14, 222-23 (1985).

[207] Koch & Koplow, *supra* note 145, at 264, 302, 305. The Conference has recommended restructuring the Appeals Council to reduce its currently overwhelming caseload and to focus its attention on systemic improvements, 1 CFR §305.87-7.

Part III portrayed the decisional independence of legislative judges as more resembling that of federal judges than that of agency adjudicators. Key to this conclusion was the institutional separation that legislative courts have from those they review, as contrasted with the compromised neutrality that attends combination of functions in agencies.

Part IV concluded that federal courts should retain their ultimate power to declare the law, but that legislative courts could better perform some initial review functions. Specialized review offered special potential for more thorough fact review, gathered in one institution for improved consistency.

From all of this no panacea emerges, for specialization is always a matter of tradeoffs. Yet there is an institutional structure that does appear to capture most of the benefits of specialization, while minimizing its costs. That structure employs a semi-specialized legislative court sitting nationwide to review both high-volume, fact-intensive agency adjudications, and some other programs that especially need specialization. From that court appeals would flow to the CAFC, itself a semi-specialized court that can provide informed review and that can articulate uniform national law.

Obviously, such a structure could not concentrate all review in a single administrative court; nor should we attempt to do so.[208] Instead, the point is to be selective, picking programs that most need institutional change and that can most benefit from the attributes of this particular scheme. Certainly, reasonable minds could differ on the particular mix of jurisdiction to assign the new court. I offer general criteria for programs to be included, and some specific nominees. The point of beginning is a unique structure that Congress recently created for review of veterans' benefits determinations by legislative and constitutional courts. This could form the core of a more generalized institution for other federal programs as well.

## A. The Court of Veterans Appeals

In 1988 Congress ended its longstanding preclusion of judicial review of veterans' claims decisions[209] and created the Court of Veterans Appeals, a legislative court with exclusive initial review jurisdiction over issues of law, fact, and constitutionality arising under laws administered by the Department of Veterans' Affairs (VA).[210] The President appoints its seven judges for 15-year terms, and may remove them only for cause. The court may sit nationwide.[211] Although only veterans and not the VA may invoke the court's jurisdiction, the VA does appear through its General Counsel.[212] Review is on the administrative record, and the court may set aside VA fact determinations that are "clearly erroneous."[213] This test was used in place of the more familiar "substantial evidence" or "arbitrary and capricious" formulas in order to allow intensified fact review.[214]

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[208] For discussion of the disadvantages of a single administrative court (principally large size and inconvenience), see Bruff, *supra* note 90.

[209] *See generally* Rabin, *supra* note 195.

Either a veteran or the agency may appeal to the CAFC, which may consider issues concerning the validity of statutes, regulations, and policies, but not errors of fact.[215] Some jurisdictional litigation is sure to flow from this restriction. Where the law-fact distinction is cloudy, the legislative history stresses the difference between decisions of general importance and those limited to the correctness of a particular award.[216] From the CAFC, review may be sought in the Supreme Court.

Obviously, the unique politics of veterans' claims infuse this delicate scheme. With one hand, Congress gave veterans--but not the agency--a right to appeal to a new forum having exceptional power to overturn agency fact judgments. With the other hand, Congress made the legislative court's fact determinations safe from further review in federal court. Only the latter feature is suited to wider use, however. An agency as well as an affected individual should have appeal rights to a legislative court, to show the court the full range of controversies the agency decides. Also, the court should perform ordinary fact review for substantial evidence. True, the purpose of vesting this review in a legislative court is to allow more thorough inspection of the administrative record than federal district judges can provide. But that does not mean that the ultimate standard of review should be altered from one that has proved itself in administrative law to another that is geared to relationships between federal district and circuit judges.

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[210] Pub. L. No. 100-687, 102 Stat. 4105; *see generally* H.R. Rep. No. 100-963, 100th Cong., 2d Sess. (Pt. 1, 1988); Stichman, *The Veterans' Judicial Review Act of 1988: Congress Introduces Courts and Attorneys to Veterans' Benefits Proceedings*, 41 AD. L. REV. 365 (1989).

[211] Congress gave the new court discretion to sit by single judges or in panels, and to decide the extent to which it will hear cases outside Washington, DC 38 U.S.C. secs. 4054(b), 4055, 4056.

[212] Although the new court's caseload is not yet clear, estimates can be made by comparing appeals rates in somewhat similar SSA disability cases. The SSA's Appeals Council, like the Board of Veterans' Appeals in the VA, decides about 40,000 cases per year, from which over 10,000 appeals have flowed in recent years. See Judicial Review of Veterans' Affairs, Hearing Before the House Comm. on Veterans' Affairs, 100th Cong., 2d Sess. 259-66 (Statement of Paul R. Verkuil) (Ser. 100-60, 1988).

[213] 38 U.S.C. sec. 4061(a)(4).

[214] Stichman, *supra* note 210, at 375-77.

[215] 38 U.S.C. sec. 4092.

[216] The CAFC may reverse a decision "resting upon a policy judgment, reasoning, or factual premise so unacceptable as to render the matter arbitrary or capricious", but may not review allegations of "an erroneous factual determination nor could it review the application of any law or regulation to those facts." H.R. Report, *supra* note 210, at 8.

In its other features, the scheme correctly follows principles of comparative institutional competence. It recognizes that constitutional decisions need the full independence of viewpoint that Article III courts possess. True, agencies should consider the constitutionality of their programs and procedures insofar as their statutes allow change to meet constitutional objections.[217] But neither they nor legislative courts possess the attributes for final decision of these issues. Legislative courts such as the CVA stand in a closer relation to the agencies they review than do Article III courts. This produces advantages for other issues, but disadvantages for constitutional ones. For most issues, both substantive and procedural constitutional review are supposed to be deferential and unconfining; the counterweight is that they be performed by officers whose neutrality is protected by complete independence from the political branches.

For issues of law, again the ultimate check of an Article III court is necessary, but agencies and legislative courts can play unique and important intermediate roles. Centralized legal monitoring by these entities can be closer than in constitutional courts. The Supreme Court's recent mandates that federal courts pay special deference to agency judgments on issues of law[218] and procedure[219] probably resulted from judicial decentralization and overload.[220] They also had separation of powers overtones based on the limited role of the federal courts that would not necessarily apply with the same force to legislative courts. Specialized initial review can deal more confidently with issues about the structure and implied purpose of an agency's statute or about optimal procedure than can generalized judges who touch these matters only occasionally. Also, a unified reviewing court avoids problems of inconsistent directives to agencies that currently hamper review by the decentralized federal courts.[221] To be sure, this is a delicate matter.

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[217] *See* Note, *The Authority of Administrative Agencies to Consider the Constitutionality of Statutes*, 90 HARV. L. REV. 1682 (1977).

[218] Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984).

[219] Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc., 435 U.S. 519 (1978).

[220] Strauss, *supra* note 6.

[221] Bruff, *supra* note 90.

Specialized review can readily degenerate into intrusion into issues of law and policy that agencies should decide. Still, jurisdictional adjustments can calibrate a court's proximity to the agencies it reviews, as we shall see.

For issues of fact, the typical structure of a legislative court, such as the Court of Veterans Appeals, should produce sufficient independence to justify finality. The judges and their employing institution are outside the agency, and are therefore less subject to subtle socializing influences than are ALJs or similar adjudicators. Moreover, several of the factors that cause constitutional courts to stay their hands by invoking nonreviewability doctrine are present: high volume, a need for specialization, and the presence of an outside check on administration.

The principal disadvantage of this structure is the danger of capture by an agency or an interest group, or the perception that it has occurred. The VA is meant to be responsive to veterans' interests--that is the reason for its existence. The Court of Veterans Appeals could all too easily become Commerce Court II. Longstanding legislative courts such as the Tax Court and the Court of Customs and Patent Appeals have weathered charges of bias, but not without difficulty. In an effort to dampen bias by broadening jurisdiction, proposals have floated to form a legislative court to hear appeals from many government benefits decisions, into which veterans' claims could be folded.[222] Let us examine that possibility.

## B. A Benefits Court

Among federal benefits programs, social security disability has produced the most frequent proposals for specialized review.[223] In the wake of the new veterans' legislation, expansion of the CVA/CAFC model to include SSA disability has attracted support.[224] The issues and procedures in federal disability programs, or even in benefits programs more generally, are similar enough to invite such consolidation.[225]

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[222] E.g., Study Committee Report, *supra* note 2, at 57.

[223] *See generally* Rains, *A Specialized Court for Social Security? A Critique of Recent Proposals*, 15 Fla. St. U. L. REV. 1 (1987); Arner, *The Social Security Court Proposal: An Answer to a Critique*, 10 J. LEGIS. 324 (1983); Ogilvy, *The Social Security Court Proposal: A Critique*, 9 J. LEGIS. 229 (1982); J. Mashaw, C. Goetz, F. Goodman, W. Schwartz, P. Verkuil & M. Carrow, *Social Security Hearings and Appeals* 146-50 (1978).

[224] Levy, *Social Security Disability Determinations: Recommendations for Reform*, 1990 B.Y.U. L. REV. 461.

[225] Adding SSA appeals would approximately double the CVA's caseload, and presumably also its size. See note 212 supra. See also 1989 Annual Report of the Director of the Administrative Office of the United States Courts [hereafter, 1989 AO Report], Table S-10,

Even if the CVA became a benefits court, though, appointments problems would remain. The political issues are simple enough (claimant vs. taxpayer orientation) to invite focused and intense lobbying by affected interests. For example, veterans' and other benefits recipients' support groups would agree on desirable characteristics in nominees. Hence, I conclude that although a new legislative court should contain a benefits review component, it should have an even broader jurisdiction to diffuse appointments pressures.

## C. A Semi-Specialized Administrative Court

The best way to maximize the benefits of specialized review while minimizing the detriments may be to broaden the veterans' review model to include a range of subjects other than federal benefits. That is, the new court's jurisdiction should be semi-specialized--broad enough to remove litmus tests in the appointments process and to avoid comparisons to the assembly line, narrow enough to allow regular and informed monitoring of the agency programs selected. The exact mix of jurisdiction chosen for the new court is not crucial if these criteria are met.

It should not be necessary to match the numbers of benefits cases with other kinds of cases on the court's docket. (The benefits cases are so numerous that an administrative court would have to be quite large to do so.) It is enough to assign meaningful numbers of other kinds of cases, especially those that ordinarily merit plenary review. Thus, fewer numbers of more time-consuming cases would significantly diversify the court's daily workload. The prestige of the court would be raised and interest in its operations would be widespread enough to diffuse appointments pressures.

Hence I propose a new Article I Administrative Court, to have initial review jurisdiction over selected programs, final as to fact for some of them. Review of this court could be assigned to the Article III CAFC, reinforcing the current status of that court as a leader in administrative review, like the D.C. Circuit. The Administrative Court would sit nationwide, providing single-judge review for some high-volume, fact-intensive programs such as veterans and social security benefits. Other matters could be decided by panels, and without factual finality. When the new court sat in such an appellate capacity,

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revealing that of the 10,206 Social Security cases filed in district courts in 1989, 9,728 concerned disability, including SSI cases. The 1990 Annual Report of the Director of the Administrative Office of the United States Courts [hereafter, 1990 AO Report] shows a drop to 7,048 disability cases (Table C2). The added burden to the CAFC is harder to estimate, due to the restriction on review of fact issues. In recent years, there have been about 1,000 SSA appeals to the circuit courts. Levy, *supra* note 128, at 480.

further review in the federal courts could be made discretionary, to avoid duplicative appellate review.

Thus, either limited circuit-riding or decentralized organization would be needed for the new court. It would not be fair to concentrate all initial review of important agency decisions in Washington.[226] The benefits programs, with small money value but high importance to affected individuals, especially demand a local forum.[227] Some specialized courts have ridden circuit in the past.[228] The attendant inefficiencies can be avoided if the court has enough business to justify permanent locations around the nation. To avoid geographic inconsistencies in the law, it would then be necessary to provide a mechanism for part or all of the full court to review decisions of its local components.[229]

Enrichment of the court's diet could be accomplished by reassigning some jurisdiction that is vested in specialized fora. Elements could include the Claims Court's nontax jurisdiction,[230] appeals from the International Trade Commission,[231] enforcement cases now decided by special split-enforcement tribunals,[232] and appeals from the Merit Systems Protection Board.[233] Patents cases now found in district court could be transferred to the Administrative Court to give it and the CAFC more complete control over that subject matter.[234] Also, Congress could reassign the portions of immigration jurisdiction currently vested in district court.[235] (Deportation cases, currently mostly reviewed in circuit court, may involve sufficiently important interests to deserve immediate resort to a constitutional court.) Appeals from decisions of the National Labor Relations Board could be shunted from the circuit courts.[236]

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[226] The Supreme Court has shown some concern about the fairness of narrow venue restrictions. In Adamo Wrecking Co. v. United States, 434 U.S. 275 (1978), the Court softened a requirement that certain EPA standards be challenged in the D.C. Circuit within a short period, by allowing affected firms that had foregone appeal to litigate the issue whether the standard in question was within the scope of the restriction. In passing, the Court remarked that the "severity" of the scheme was accentuated because small firms could protect their rights only by "daily perusal of . . . the Federal Register and by immediate initiation of litigation in the District of Columbia to protect their interests." 434 U.S. at 283 n.2. Justice Powell, concurring, thought the restriction arguably raised a due process issue by its short deadline and inadequate notice. Thus, attempts to centralize administrative review can raise the Court's hackles. Even with efforts to provide adequate notice, inconvenience to private litigants could be sufficient to impair review rights in some cases.

[227] For the relatively few cases presenting issues of programmatic importance, placing appellate venue in the CAFC should not pose extreme inconvenience. These cases are likely to attract support from interest groups such as recipients' organizations.

[228] Dreyfuss, *supra* note 3, at 422 n.191.

[229] For a survey of available techniques, including limited en banc review, see Bruff, *supra* note 90. See also H. Dubroff, *supra* note 35, at 352-53, summarizing a "conference system" involving panel review of single-judge decisions, used by the Tax Court to promote uniformity.

[230] In 1989, 717 complaints were filed in the Claims court, including 170 tax cases. 1989 AO Report, Table G-3a. In the same year, 112 appeals were filed in the CAFC from the court. Id., Table G-2.

[231] In 1990, there were eight appeals from the ITC to the CAFC. 1990 AO Report, Table A.

[232] In 1989, there were 12 FMS & HRC appeals in the circuit courts, and 11 OSHRC appeals. 1989 AO Report, Table S-1. Of course, these appeals represent a substantially larger number of cases brought in those two fora.

Tax cases from the Claims Court, the Tax Court, and the district court may deserve separate treatment.[237] The complexity of tax law and the breadth of the issues it raises suggest the wisdom of a specialized court deciding only tax cases. Still, the present Tax Court could be established as a separate division of the Administrative Court, to exercise all initial review functions in tax cases.[238] Appeals from this division would then go to the CAFC, as with the Administrative Court's other cases.[239]

To discharge its various responsibilities, the nontax division of the Administrative Court might need about 20 judges, a number comparable to that of the Tax Court. Such a court could hear cases in the nation's cities, as the Tax Court does.[240] Of course, it is difficult to predict necessary staffing for a court not yet established. But one of the virtues of legislative courts is that their number of judgeships can be adjusted with relative ease. As for the CAFC, its present size of 12 might remain sufficient, or nearly so, because

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[233] In 1989, there were 590 MSPB appeals to the CAFC. Id., Table G-2. For 1990, the figure was 687. 1990 AO Report, Table A.

[234] See note 29 *supra*. To identify cases belonging in the new court, the well-pleaded complaint rule that the CAFC uses to define its appellate jurisdiction could be employed.

[235] For surveys of judicial review in immigration law, see D. Martin, Major Issues in Immigration Law (Fed. Jud. Ctr. 1987); Legomsky, *supra* note 77. In 1989, 285, 424 petitions for naturalization were filed in the district courts. 1989 AO Report, Table S-23.

[236] See R. Posner, supra note 14, at 149 (suggesting specialized treatment of these cases). In 1989, there were 543 NLRB appeals filed in the circuit courts. 1989 AO Report, Table S-1.

[237] Study Committee Report, *supra* note 2, at 69-71; Kramer, *supra* note 39.

[238] In 1989, 170 tax cases were filed in Claims Court, 1989 AO Report, Table G-3a; 2,555 were filed in district court, id. Table C-2; 31,453 were filed in the Tax Court, U.S. Tax Court, FY 1989 Annual Report.

[239] In 1989, there were 419 circuit court appeals from the Tax Court, 1989 AO Report, Table S-1., and 310 from the district courts, id. Table B-1A.

[240] The 19 judges of the Tax Court hear cases in about 80 cities.

some of its present cases would be shunted to the Administrative Court, never to return.[241]

Whatever the final jurisdictional package chosen for an Administrative Court, the opportunity exists to provide the federal courts some relief from review responsibilities that they are too overloaded to discharge well or happily,[242] and to improve the quality of both individual case disposition and overall agency monitoring. Equally important, a centralized system for administrative review can articulate uniform national law for the programs it considers.

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[241] In 1989, the Circuit received 1,417 appeals, 590 of them from the MSPB. 1989 AO Report, Table G-2. For 1990, the total was 1,466, with 687 of them from the MSPB. 1990 AO Report, Table A.

[242] Although creation of an Administrative Court would provide the federal courts some docket relief, it would not contribute importantly to resolution of the current caseload crisis there. All administrative cases comprised only 10% of the federal courts' cases in 1990. See Bruff, *supra* note 90.

## Report for Recommendation 91-10

# Reform of the Administrative Procedures Used in U.S. Antidumping and Countervailing Duty Cases

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This report was prepared for the consideration of the Administrative Conference of the United States. The views expressed are those of the author and do not necessarily reflect those of the members of the Conference or its committees except where formal recommendations of the Conference are cited.

# Executive Summary

This report discusses several possible reforms of the administrative procedures used in U.S. antidumping (AD) and countervailing duty (CVD) cases. These cases usually arise when a petition is filed on behalf of a U.S. industry by one of several statutorily specified interested parties asking the U.S. government to impose special duties to offset dumping or subsidization. The government itself can initiate cases.

Dumping occurs when foreign companies export goods to the United States for sale at less than their "fair value." Fair value is generally based on the exporter's prices for such goods in its home (or a third country) market or on its cost of producing the goods (including a profit margin). AD duties are imposed to offset the margin of dumping (i.e., the difference between the foreign market value and the U.S. price) if the U.S. industry producing like products has suffered or is threatened with material injury by reason of the dumped imports or if the establishment of a U.S. industry producing such products has been materially retarded.

Countervailing (CV) duties may be imposed on goods exported to the United States that benefit from certain types of subsidies granted by a foreign government. In most CVD cases, duties may be imposed only if U.S. industry producing like goods has suffered or is threatened with material injury by reason of the subsidized imports or if the establishment of a U.S. industry producing such goods has been materially retarded.

The decision whether dumping or subsidization has occurred is made by the International Trade Administration (ITA) of the Department of Commerce; the decision on injury is made by the United States International Trade Commission (ITC). These administrative decisions are subject to review in the first instance in the Court of International Trade (CIT) and then in the Court of Appeals for the Federal Circuit. In the case of Canadian exports, the administrative decisions may be "appealed" instead to a binational panel established under the U.S.-Canada Free Trade Agreement.

In connection with our study of the current procedures, the two general concerns that seemed to us to be foremost in the minds of trade law practitioners were (i) reducing the time and expense associated with AD and CVD proceedings and (ii) improving the hearing process so as to ensure impartial, consistent decisions by the administrators of the relevant statutes. Accordingly, the report focuses on several possible reforms of the present system that might improve the impartiality and operation of the hearing process used in these cases and promote cost and time efficiency.

In comparing the U.S. system to the systems of the other major users of AD/CVD laws, we concluded that the U.S. system compared favorably to those systems in terms of impartiality and the operation of the investigative process, but that the other systems were generally less time consuming and much less costly in their operation.

In light of our work, this report considers reforms in four areas: (i) the hearing procedure at the ITA and ITC; (ii) ways to reduce time and expense in ITA proceedings, (iii) reform of certain practices at the ITC, and (iv) possible elimination of appeals to the CIT.

## The Hearing Procedure at the ITA and ITC

Although we did not find major problems with the U.S. system in terms of impartiality and the operation of the investigative process, we found that some participants felt the system was not sufficiently impartial and that many participants felt the hearing process was deficient. It seemed to us that there was much to be said for having the basic decision on dumping/subsidization and injury made by an administrative law judge (ALJ). Because the ALJs would be isolated from the political process, we felt that the use of ALJs would reduce perceptions of partiality in the U.S. AD/CVD system. It would also improve the hearing process. This recommendation was not adopted by the Committee on Regulation.

The Committee felt instead that it would be possible to improve the hearing process at the ITA and ITC with less farreaching changes. The report considers several such changes and concludes that the ITA hearing process would be improved if the hearing officer were more knowledgeable about the contested issues and participated more actively in interchanges with counsel than is currently the case. The ITC hearing process would be improved if, in setting the times for argument, the ITC took into account factors such as the complexity of the case and the number of parties involved. The ITC should also allow reasonable time for cross-examination without taking such time from the questioner's time for affirmative presentation.

## Reducing Time and Expense in ITA Proceedings

In our preliminary report we made a number of recommendations that we thought would offer the potential of significant cost savings. Although none of those ideas were adopted by the Committee on Regulation, the report considers and endorses a number of other more limited improvements in ITA procedures.

First, faster preparation of the administrative record by the ITA would speed up the appeals of cases.

Second, the ITA could and should streamline and standardize its procedures for handling routine protective order disclosure requests so as to reduce the amount of time spent by the parties in preparing such requests, thereby reducing costs. The ITA should also strive to reduce parties' costs by reducing where at all possible the number of copies of documents required to be filed.

Third, the ITA now sometimes decides to reject a party's factual submissions without notice or to change its methodology for calculating dumping/subsidy margins without opportunity for the parties to comment. It would be desirable for the ITA to give notice of such rejections and to give an opportunity to comment on such changes. Implementation of this recommendation would allow parties to argue their positions more effectively and avoid wasted effort.

Fourth, at present there are a number of inconsistencies between the way that the ITA's investigations office (which handles the initial investigation to determine whether an AD/CVD order should be issued) and the ITA's compliance office (which reviews shipments made after the issuance of an AD/CVD order to assess the amount of duties owing) handle certain issues. Since there is no justification for these inconsistencies, the ITA ought to eliminate them.

Fifth, under U.S. law the actual amount of AD/CV duties owed is usually determined after the fact. While exporters deposit an estimated duty when goods are imported into the United States, that amount may be adjusted upwards or downwards as a result of an annual review, if requested. (If not requested by anyone, the estimated duties are collected as the final duties.) The ITA has traditionally had a large backlog of annual reviews, although it has been reducing it in recent years. The delay in finally determining duties owed is unnecessarily disruptive to trade flows and unfair to the parties to the case. Accordingly, the ITA should attempt to eliminate its backlog of annual reviews.

## Reforms at the ITC

In the course of our study, several complaints were made about the structure of the ITC. We found one to be particularly meritorious. The commissioners of the ITC apparently do not normally meet as a group to discuss their views of a case before their formal deliberations, apparently because of concerns stemming from the Government in the Sunshine Act. It appears that this practice adversely affects the ITC decision-making process. To improve collaboration in its decision-making, the ITC should take steps to exchange drafts, views, and other information before entering into formal deliberation, so as to encourage collegial decision-making. If the Sunshine Act impedes it from doing so, the Act should be amended.

### Possible Elimination of Appeals to the CIT

Finally, agency action in AD/CVD cases can be appealed as a matter of right first to the Court of International Trade and then to the Court of Appeals for the Federal Circuit. We think that serious consideration should be given to eliminating CIT review in AD/CVD cases, even if an ALJ system is not established.

## Introduction

This report discusses several possible reforms of the administrative procedures used in U.S. antidumping (AD) and countervailing duty (CVD) cases. These cases usually arise when a petition is filed on behalf of a U.S. industry by one of several statutorily specified interested parties asking the U.S. government to impose special duties to offset dumping or subsidization. The government itself can also initiate cases.

Dumping occurs when foreign companies export goods to the United States for sale at less than their "fair value." Fair value is generally based on the exporter's prices for such goods in its home (or a third country) market or on its cost of producing the goods (including a profit margin). AD duties are imposed to offset the margin of dumping (i.e., the difference between the foreign market value and the U.S. price) if the U.S. industry producing like goods has suffered or is threatened with material injury by reason of the dumped imports or if the establishment of a U.S. industry producing such goods has been materially retarded.

Countervailing duties may be imposed on goods exported to the United States that benefit from certain types of subsidies granted to the exporters by a foreign government. In most CVD cases, duties may be imposed only if U.S. industry producing like goods has suffered or is threatened with material injury by reason of the subsidized imports or if the establishment of a U.S. industry producing such goods has been materially retarded.

The decision whether dumping or subsidization has occurred is made by the International Trade Administration of the Department of Commerce; the decision on injury is made by the United States International Trade Commission. These administrative decisions are subject to review in the first instance in the Court of International Trade and then in the Court of Appeals for the Federal Circuit. In the case of Canadian exports, the administrative decisions may be "appealed" instead to a binational panel established under the U.S.-Canada Free Trade Agreement.

In recent years, the use by the United States and other countries of AD/CVD laws has been controversial. Critics have contended that these laws, which were originally intended to combat specific unfair trade practices, are now being applied as general instruments of protection to shield domestic industries from appropriate international competition. Indeed, the mere announcement of an AD or CVD investigation is claimed to have a trade disruptive effect.

While many of the complaints about these laws are essentially about their substantive provisions, a number of the complaints concern procedural matters. In particular, some critics have contended that the procedures used in U.S. AD/CVD cases are unnecessarily time consuming and expensive and are not sufficiently insulated from the political process. In this report we review a number of these criticisms of the procedures used in AD/CVD cases and suggest several reforms to the current system. While the line between substance and procedure is often hard to draw, the issues discussed in this report, in our view, are clearly procedural.

The interest of the Administrative Conference of the United States in AD/CVD procedures has arisen as a result of several factors. First, these procedures were radically overhauled in 1979 and have never been studied generally by the Administrative Conference.[1] Second, there have been many voices raised in recent years to the effect that these procedures are deficient. Since there has been 10-years' worth of experience with the procedures, the time seems ripe to evaluate them. Moreover, it is likely that the AD and CVD laws will be revised in 1992, assuming a successful completion of the Uruguay

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[1] In 1973, the Conference studied the then existing procedures for administering AD cases. See Warren F. Schwartz, The Administration by the Department of the Treasury of the Laws Authorizing the Imposition of Antidumping Duties (1973)[hereinafter referred to as the "Schwartz Report"]. A revised version of the Schwartz Report appears as Schwartz, Comment: The Administration by the Department of the Treasury of the Laws Authorizing the Imposition of Antidumping Duties, 14 VA. J. INTL. L. 463 (1974). On the basis of the Schwartz Report, the Conference made a number of recommendations on reforming the AD rules. See Recommendation 73-4, adopted December 18, 1973.

In 1984, the Conference studied one narrow aspect of current AD/CVD procedures--the availability of confidential information under protective order in proceedings of the International Trade Commission. The report submitted to the Conference is contained in Anthony & Bryne, "Safeguarding Confidential Information in ITC Injury Proceedings: Proposals to Reduce the Risks of Disclosure, 17 LAW & POL. INTL. BUS. 1 (1985). The report served as a basis for Recommendation 84-6, "Disclosure of Confidential Information Under Protective Order in International Trade Commission Proceedings," adopted December 6, 1984.

Round of trade negotiations now being held under the auspices of the General Agreement on Tariffs and Trade (GATT). For this reason as well, it is an auspicious time to consider whether basic changes should be made in the procedural aspects of these laws.

To decide on the precise scope of our investigation, we met with senior government trade officials and leading members of the international trade bar in Washington, DC on October 19, 1989, to discuss (i) how current administrative procedures in AD/CVD cases are working and (ii) what changes they believed could usefully be made to such procedures. We took their suggestions into account in structuring the project as indicated in our Preliminary Outline of November 8, 1989.

The two general concerns that seemed to us to be foremost in the minds of trade law practitioners were (i) reducing the time and expense associated with AD/CVD proceedings and (ii) improving the hearing process so as to ensure impartial, consistent decisions by the administrators of the relevant statutes. Accordingly, we decided that the focus of the project should be a study of several possible reforms of the present system that might significantly promote cost and time efficiency and improve the impartiality and operation of the hearing process used in these cases.

A preliminary draft of this report, dated February 4, 1991, was circulated for comment to the relevant government agencies and to a number of international trade lawyers in Washington and New York who have manifested an interest in reforming these procedures. The preliminary draft was also the subject of a panel discussion at the International Trade Breakout Session at the May 9, 1991, Federal Circuit Judicial Conference and was distributed to those attending the Conference. We received a number of written comment letters on the draft report, and many additional oral comments were made during the four one-half day meetings that the Administrative Conference's Committee on Regulation devoted to discussing the draft report. The comments reflected the wide diversity of opinion on these procedures. Some were supportive; others were quite critical. In addition, both prior to and subsequent to the circulation of the draft report, we each spoke (individually and in some cases jointly) with many individuals involved in the administration of the current procedures, including private practitioners and government officials.[2]

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[2] To obtain candid comments from these individuals, we told them, if they asked, that the report would not attribute any remarks to specific individuals. We believe that the opportunity given both private practitioners and government officials to comment on the report has meant that the accuracy of statements made to us on and on which we relied has been adequately tested without having to attribute statements to specific individuals. We accept full responsibility for our conclusions.

As noted below, this report does not discuss a number of changes proposed in the preliminary report since the Committee on Regulation decided to make no recommendations with respect to those changes. In the report, we first review the history of AD/CVD laws and how they relate to basic international trade policy issues. We then outline the AD/CVD procedures now used in the United States and several foreign jurisidctions. Finally, we discuss several possible reforms.

## I. AD and CVD Statutes and the Regulation of Unfair Practices in International Trade

AD and CVD laws have a long history. The United States adopted its first CVD law in 1897,[3] and its first comprehensive AD statute in 1921.[4] Other countries have had similar provisions for even longer periods.[5] The use of such laws is explicitly permitted by the General Agreement on Tariffs and Trade (GATT), which in article VI (i) condemns dumping by companies of one country that causes material injury to the domestic industry of another country,[6] (ii) authorizes the application of AD duties to offset dumping,[7] and (iii) permits the use of CV duties to offset subsidies causing material injury to a nation's domestic industry.[8] Article VI does not regulate in any detail the procedures to be used in processing AD and CVD cases and addresses the substantive issues only in very general terms.

In the Kennedy Round of trade negotiations, held under GATT's auspices from 1963 to 1967, a number of participating countries reached agreement on more detailed substantive and procedural rules to be applicable to AD cases. This agreement, known as the 1967 Antidumping Code,[9] had limited impact, however, because the U.S. Congress essentially forbade U.S. compliance with it, even though the United States was a party to it.[10] In 1979, the Tokyo Round of Multilateral Trade Negotiations led to the adoption by the industrialized GATT members, and some developing countries as well, of two side agreements to the General Agreement--the Antidumping Code,[11] which regulates the imposition of AD duties, and the Subsidies Code,[12] part of which governs the use of CV duties. At the moment, in the context of the Uruguay Round of GATT trade negotiations, both of these codes are under discussion and both may be changed in part if those negotiations, which broke down in December 1990, are successfully completed.

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[3] See J. Jackson & W. Davey, *Legal Problems of International Economic Relations* 748 (2d ed. 1986).

[4] See Davey, "Antidumping Laws: A Time for Restriction," in 1988 Fordham Corporate Law Institute Proceedings 8-1, 8-3 (B. Hawk ed. 1989). The United States adopted a law directed at predatory dumping in 1916 (15 U.S.C. §72), but it has apparently never been successfully invoked. J. Jackson & W. Davey, supra note 3, at 800-801.

[5] See Davey, supra note 4, at 8-3.

[6] General Agreement on Tariffs and Trade, art. VI:1. The official text of the General Agreement appears in volume IV of the series Basic Instruments and Selected Documents, which is published by the Contracting Parties to the General Agreement on Tariffs and Trade.

[7] GATT, art. VI:2.

[8] GATT, art. VI:3. The General Agreement authorizes the use of CVD duties in a backhanded way. It provides only that such duties shall not exceed the amount of the subsidy. The General Agreement does not restrict the use of domestic subsidies, although it does forbid the use of certain export subsidies. GATT, art. XVI. See generally Davey, An Overview of the General Agreement on Tariffs and Trade §II.C.2, in P. Pescatore, W. Davey & A. Lowenfeld, *Handbook of GATT Dispute Settlement* (1991).

Despite their long history, both AD and CVD laws remain quite controversial. This is probably due in part to the fact that although they have existed for many years, they were not often utilized prior to the Tokyo Round. For example, it appears that there were approximately 84 CV duties applied from 1897 through mid-1973.[13] While AD cases were more common, there were only 34 outstanding AD orders at the end of 1972.[14] In contrast, as of December 31, 1990, there were 197 outstanding AD orders and 72 outstanding CVD orders.[15]

The increased use of these procedures can also be seen in the large numbers of AD and CVD cases that were filed in the United States during the 1980s:[16]

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[9] GATT, Basic Instruments and Selected Documents, 15th Supplement 74 (1968).

[10] See J. Jackson & W. Davey, supra note 3, at 670-673.

[11] GATT, Basic Instruments and Selected Documents, 26th Supplement 171 (1980)(Hereinafter the "Antidumping Code").

[12] Id. at 56 (Hereinafter the "Subsidies Code").

[13] J. Jackson & W. Davey, supra note 3, at 751.

[14] See 19 CFR §153.43 (1973). Five years earlier, there were only 17 outstanding AD orders. See 19 CFR §53.43 (1968).

[15] International Trade Commission, Operation of the Trade Agreements Program, 42nd Report, 1990, Tables A-20 & A-22 (USITC Pub. No. 2403, July 1991) [Hereinafter "ITC 1990 Report"]. As of December 31, 1989, there were 192 AD orders and 76 CVD orders in effect. Id., 41st Report, 1990, Tables A-27 & A-29 (USITC Pub. No. 2317, Sept. 1990) [Hereinafter "ITC 1989 Report"]. As of December 31, 1988, there were 163 AD orders and 77 CVD orders in effect. Id., 40th Report, 1988, Tables B-20 & B-22 [Hereinafter "ITC 1988 Report"].

[16] 1989 Annual Report of the President of the United States on the Operation of the Trade Agreements Program 76 (1990)(for the years 1981-88); ITC 1989 Report, supra note 15, Tables A-26 & A-28 (for 1989); ITC 1990 Report, supra note 15, Tables A-19 & A-21 (for 1990). Many of the large number of cases filed in 1982 involved steel products.

| Year | AD Cases | CVD Cases |
|---|---|---|
| 1981 | 19 | 14 |
| 1982 | 71 | 124 |
| 1983 | [46] | 31 |
| 1984 | 73 | 53 |
| 1985 | 62 | 41 |
| 1986 | 65 | 28 |
| 1987 | 15 | 8 |
| 1988 | 42 | 13 |
| 1989 | 23 | 7 |
| 1990 | 43 | 7 |

The dramatic increase in the 1980s in the use of AD and CVD laws has intensified concerns about their appropriateness and their effect on international trade.[17]

In the case of AD laws, some commentators question their economic rationale, question whether dumping is really an unfair or harmful practice at all, and argue that the substantive provisions in most AD laws are unfairly biased against exporters.[18] In the eyes of these critics, AD laws are used mainly for protectionist purposes. Some critics argue that the laws should be restricted in scope or even repealed and that the antitrust laws should be relied upon to combat unfair trade practices.[19] On the other side of the argument are those that point to the long history of AD laws, the condemnation of dumping expressed in the General Agreement on Tariffs and Trade and the unfairness and injury that results from dumping.[20] Others take a more pragmatic view, essentially viewing AD laws as a useful interface mechanism that operates to relieve strains between national economies.[21] Despite this controversy, it seems likely that AD laws will continue to exist, certainly for the next decade, even if their scope of application is reduced as more and more free trade areas are created.[22]

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[17] The initiation of new AD/CVD cases in the United States has fallen off in the last several years, although the number of outstanding AD/CVD orders continues to grow. The use of these procedures is expected to increase significantly if the current quantitative restrictions on textiles and apparel are phased out, as has been proposed in the Uruguay Round, and if current steel import quotas expire as scheduled in 1992.

[18] These, and other similar arguments, are reviewed favorably in Davey, supra note 4.

[19] This view was held by Professor Schwartz, see Schwartz Report, supra note, and is also held by one of the co-authors of this report. See generally Davey, supra note 4.

[20] See, e.g., H. Beseler & N. Williams, *Anti-Dumping and Anti-Subsidy Law: The European Communities 41-52* (1986).

[21] See J. Jackson, *The World Trading System* ch. 10 (1989).

CVD laws also are controversial, although much of this controversy stems not from disagreement as to whether there should be some sort of control over subsidies, but rather over how much control is appropriate. There is a fear that without some controls on the use of subsidies, particularly subsidies tied to exports, there will be undesirable competition between countries in the use of subsidies. Thus, although the European Community does not recognize the possibility of intra-Community dumping, it has an elaborate mechanism to control the granting of trade-distorting subsidies by its member states and their regional and local authorities.[23]

Although many countries have CVD laws, in recent years only the United States has made extensive use of a CVD statute.[24] Much of the controversy surrounding the U.S.' use of its CVD rules has centered on the definition of countervailable subsidy. There seems to be general agreement among the leading members of GATT that some types of subsidies should be banned, particularly direct export subsidies on industrial products.[25] There is

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[22] It has been typical in more comprehensive free trade areas, such as the European Community, the proposed European Economic Area and the Australian-New Zealand Agreement on Closer Economic Relations, to abolish AD laws for internal trade on the theory that such laws are not needed if goods in fact flow freely back and forth across member country boundaries and effective antitrust laws exist. See H. Beseler & N. Williams, supra note, at 33. The Canada-United States Free Trade Agreement in article 1906 envisions replacement of AD laws by some other mechanisms yet to be agreed upon.

[23] The control of subsidies, or "state aids" as they are called in EC parlance, is in the hands of the Commission and its competition directorate. The EC does not ban all subsidies, but does restrict the level of subsidization, depending on the economic health of the region where the subsidies are proposed to be granted. In a number of cases, the Commission has ordered that subsidies be repaid. See generally Caspari, State Aids in the EEC, 1983 Ford. Corp. L. Inst. 1 (B. Hawk ed.).

[24] According to reports filed with the GATT Committee on Subsidies and Countervailing Measures, the numbers of CVD cases initiated between July 1, 1986 and June 30, 1990 by signatories to the Subsidies Code were as follows:

| | |
|---|---|
| Australia | 14 (11 in 1989-90) |
| Canada | 8 |
| New Zealand | 5 |
| United States | 38 (in 1985-86: 43) |

GATT, Basic Instruments and Selected Documents, 34th Supp. 191-192 (1988); id., 35th Supp. 384 (1989); id., 36th Supp. 455 (1990); id., 37th Supp. 316 (1991).

[25] The GATT Subsidies Code prohibits the use of export subsidies on nonprimary products and limits their use on primary (i.e., agricultural) products. GATT Subsidies Code, supra note,

controversy, however, over the extent to which domestic subsidies (which obviously will allow all prices, including export prices, to be lower) ought to be prohibited or countervailable. Because the United States federal government does not directly subsidize industries as much as many other governments do, the United States takes a harder line against the use of domestic subsidies, while the more frequent users of such subsidies argue that they are legitimate government policy instruments and should not be subject to counteraction by other nations. Negotiations in both the Tokyo and Uruguay Rounds have tried to reach agreement on this question of what subsidies should be countervailable.[26]

The most controversial issues raised with respect to AD and CVD laws are substantive and essentially concern the question of how broad the scope of these laws should be (i.e., how easy should it be for domestic industry to invoke them to restrict imports.) However, the procedures pursuant to which these laws are applied may have important effects on the outcome of cases and the ability of interested parties to bring or defend AD/CVD cases. Hence, they are the subject of contention as well. This report focuses on those procedures.

## II. A Description of the Present System

In this section, we will outline the U.S. procedures for handling AD/CVD cases and then briefly compare those procedures with the administrative practices followed by the other countries that are the primary users of AD/CVD laws--the European Community, Canada, and Australia.[27]

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arts. 9, 10. The limitations applicable to primary products are viewed as largely ineffective. See J. Jackson & W. Davey, supra note 3, at 735-739.

[26] See GATT, The Tokyo Round of Multilateral Trade Negotiations: Report by the Director-General of GATT, 53-60 (1979); GATT, News of the Uruguay Round 5-6 (No. 38, 16 July 1990).

[27] As noted above, only the United States is a significant user of CVD laws. See note 24 supra. As to use of AD laws, according to reports filed with the GATT Committee on Antidumping Practices, the numbers of AD actions initiated between July 1, 1986 and June 30, 1990, by Antidumping Code signatories, were as follows:

| | |
|---|---|
| Australia | 102 |
| Brazil | 3 |
| Canada | 73 |
| EC | 91 (against Code parties only) |
| Finland | 12 |
| Korea | 4 |

## A. Description of U.S. AD/CVD Procedures

The present U.S. system for handling AD and CVD cases is complex.[28] This complexity stems in part from the need to deal with difficult substantive issues, but it is increased significantly because of the manner in which the U.S. system processes these cases--from the initial investigations by the International Trade Administration of the Department of Commerce and the International Trade Commission through judicial review of the final outcomes in the Court of International Trade and the Court of Appeals for the Federal Circuit. Congress has regulated many procedural aspects of the system in great detail, particularly by establishing strict time limits for the initial investigation period leading up to the decision to issue an AD or CVD order.[29] Thereafter, the procedural complexity of the system is increased by an "annual" review procedure and the extensive judicial review of agency actions, all of which has frequently resulted in long delays in finally determining the liability to be assessed under an AD or CVD order.

To give the reader an appreciation of this complex system, we outline in this section how a typical AD or CVD case is processed by the present system. There are three distinct stages in U.S. AD and CVD cases: first, the initial investigation, which determines whether or not an AD/CVD order will be issued; second, the annual review procedure, in which the actual amount of AD/CV duties to be collected is established; and third, the revocation

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| | |
|---|---|
| Mexico | 25 (1988-1990 only) |
| New Zealand | 13 (1988-1990 0nly) |
| Sweden | 6 |
| United States | 121 |

GATT, Basic Instruments and Selected Documents, 35th Supp. 359-361 (1989); id., 36th Supp. 439 (1990); id., 37th Supp. 301 (1991).

[28] The statutory provisions governing AD proceedings are found in Title VII, subtitles B, C and D of the Tariff Act of 1930. Those provisions are codified in 19 U.S.C. §§1673-1677j. Both the ITA and the ITC have issued regulations concerning AD proceedings. See 19 CFR pts. 207, 353, 354. The statutory provisions applicable to CVD cases are found in Title VII, subtitles A, C and D, which are found at 19 U.S.C. §§1671-1671h, 1675-1677j. The ITA and ITC regulations are at 19 CFR pts. 207, 355, 354. For an excellent brief description of the U.S. system, see Horlick, The United States Antidumping System, in J. Jackson & E. Vermulst, *Antidumping Law and Practice: A Comparative Study* 99-166 (1989).

[29] In 1979, when the current AD and CVD laws were adopted, Congress expressed considerable dissatisfaction with the way in which the laws had been administered in the past by the Treasury Department. J. Jackson & W. Davey, supra note 3, at 674-675. Although the Treasury's administrative responsibilities were shifted to the ITA in 1980, Congress has remained intimately involved in the operational details of the law.

procedures, by which cases are finally terminated. In addition, there is judicial review of all final determinations in these three stages.

## 1. Initial Investigations

An AD or CVD proceeding is typically commenced by the filing of a petition with respect to a specific product on behalf of the U.S. domestic industry producing that product.[30] Thereafter, the statute establishes strict deadlines for completion by the ITA and the ITC of the various phases of the initial investigation. Once an investigation is opened, the ITA is responsible for determining the extent of dumping or subsidization, while the ITC determines whether U.S. industry has suffered material injury. The order of their determinations is as follows: first, the ITC makes a preliminary injury determination; then the ITA makes both its preliminary and final dumping/subsidy determination; and finally the ITC makes its final injury determination. The time limits established by Congress for these determinations is as follows:

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[30] Tariff Act of 1930, §§702(b), 732(b); 19 U.S.C. §§1671a(b), 1673a(b). The term "industry" is defined to mean the domestic producers of the product as a whole or those producers whose output constitutes a major proportion of total domestic production. Absent evidence that a majority of U.S. producers (weighted by output) oppose a petition, the ITA generally assumes that the petitioner represents U.S. industry. Horlick, supra note 28, at 154.

| Action | Days After Petition Filed | |
|---|---|---|
| | AD | CVD |
| ITA decision to initiate investigation | 20[31] | 20[32] |
| ITC preliminary injury determination | 45[33] | 45[34] |
| ITA preliminary dumping/subsidy determination | 160[35] | 85[36] |
| ITA final dumping/subsidy determination | 235[37] | 160[38] |
| ITC final injury determination | 280[39] | 205[40] |

Shorter periods are established for CVD cases because the investigations are thought to be simpler in that fewer issues and less data are involved.

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[31] Tariff Act of 1930, §732(c); 19 USC §1673a(c).

[32] Tariff Act of 1930, §702; 19 USC §1671a(b).

[33] Tariff Act of 1930, §733(a); 19 U.S.C. §1673b(a).

[34] Tariff Act of 1930, §703(a); 19 U.S.C. §1671b(a).

[35] Tariff Act of 1930, §733(b)(1)(A); 19 U.S.C. §1673b(b)(1)(A). This period may be extended to 210 days if the case is determined by the ITA to be extraordinarily complicated. Tariff Act of 1930, §733(c); 19 U.S.C. §1673b(c). It may be shortened to 90 days after commencement of the investigation (which would normally be about 110 days after the filing of a petition) if (i) the ITA has sufficient information and (ii) the petitioner and certain other interested parties waive verification of that information. Tariff Act of 1930, §733(b)(2); 19 U.S.C. §1673b(b)(2). The period may also be shortened to 100 or 120 days if so-called short life-cycle merchandise is involved. Tariff Act of 1930, §733(b)(1)(B); 19 U.S.C. §1673b(b)(1)(B).

[36] Tariff Act of 1930, §703(b); 19 U.S.C. §1671b(b). This period may be extended to 150 days in certain extraordinarily complicated cases and to 250 (or 310) days in cases involving upstream subsidies. Tariff Act of 1930, §703(c),(g); 19 U.S.C. §1671b(c),(g). If adequate information is in the hands of the ITA and verification is waived, the period may be shortened. Tariff Act of 1930, §703(b)(3); 19 U.S. C. §1671b(b)(3).

[37] Tariff Act of 1930, §735(a)(1); 19 U.S.C. §1673d(a)(1). This period may be extended by 60 days in certain circumstances. Tariff Act of 1930, §735(a)(2); 19 U.S.C. 1673d(a)(2).

[38] Tariff Act of 1930, §705(a); 19 U.S.C. §1671d(a).

[39] Tariff Act of 1930, §735(b)(2); 19 U.S.C. §1673d(b)(2).

[40] Tariff Act of 1930, §705(b); 19 U.S.C. §1671d(b).

The decision by the ITA on whether to initiate an investigation is largely pro forma. At this stage, the ITA determines whether the petition properly alleges the basis for an action, contains information reasonably available to the petitioner in support thereof, and is filed by an appropriate party.[41] The ITA does not permit arguments against initiation to be made by respondents.[42]

If the ITA initiates an investigation, the ITC determines whether there is a reasonable indication that U.S. industry has been materially injured by the allegedly dumped or subsidized imports.[43] To make that determination, the ITC collects information from the U.S. industry and others through questionnaires and uses other information available to it about the industry. To staff an investigation, the ITC typically assigns to a case an investigator, an economic/financial analyst, a commodity/industry analyst from the ITC's Office of Industries and a staff attorney who writes or reviews any report issued by the ITC. Legal issues are referred to the General Counsel's office, while scope of investigation questions may receive input from the ITC office responsible for classification issues under the Harmonized Tariff System. The ITC's regulations provide for the possibility of a conference with the ITC's staff prior to the ITC's preliminary determination.[44] Conferences are typically held about 3 weeks after the petition is filed and witnesses and counsel for the interested parties attend.[45] Any post-conference briefs from the parties are due shortly after the conference is held. Thereafter, the ITC's staff prepares a report that summarizes the information collected in the investigation, and, in particular, contains detailed statistical information on the state of the U.S. industry at issue. The parties do not receive a copy of the report prior to the Commission's preliminary determination. That determination is made by a vote of the six commissioners, with tie votes counted as affirmative determinations.[46] The Commission not infrequently splits several ways on a particular issue and separate opinions are not uncommon.[47]

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[41] 19 CFR §§353.13, 355.13. Petitions may be filed by a manufacturer, producer, or wholesaler in the United States of a like product; a certified union or recognized union or group of workers representative of an industry in the United States engaged in the manufacture, production, or wholesale of a like product; a trade or business association a majority of whose members manufacture, produce, or wholesale a like product in the United States; and an association, a majority of whose members is composed of the foregoing. There is a special rule for processed agricultural products. Tariff Act of 1930, §771(9)(C)-(G); 19 U.S.C. §1677(9)(C)-(G).

[42] 19 CFR §§353.12(i), 355.12(j).

[43] 19 CFR §207.12. One major difference between AD and CVD cases is that not all CVD cases involve an injury investigation. Such investigations are held in cases involving those developed countries that are parties to the GATT Subsidies Code (without reservations) and those developing countries that (i) are parties to the Code and (ii) have made certain commitments to the United States concerning their use of subsidies. These commitments are provided for in the U.S. CVD statute and are viewed as necessary by the United States because the Subsidies Code allows (despite U.S. opposition) more leeway in the use of subsidies by developing countries than it does in the case of developed countries. Under the statute there are a few other countries that are also entitled to an injury test. Tariff Act of 1930, §701(b); 19 U.S.C. §1671(b). In addition, an injury investigation is conducted if a case involves a duty-free product from a GATT member. Tariff Act of 1930, §303(a)(2); 19 U.S.C. §1303(a)(2).

[44] 19 CFR §207.15.

[45] On the respondents' side, the statute defines interested parties as foreign manufacturers, producers and exporters of the product under investigation; the U.S. importers of that product

If the ITC preliminary determination is affirmative, the ITA continues its preliminary investigation (which goes forward in any event during the ITC's preliminary investigation). The ITA sends questionnaires to the exporters, importers, and other parties known to be involved in the case, including the relevant foreign government in a CVD case. The questionnaires aim to establish the information needed to determine whether dumping or subsidization has occurred (i.e., information on domestic and export prices, information concerning adjustments needed to make those prices "comparable", information about costs if there are allegations of below-cost sales, information about government programs and information about receipt of government benefits by individual companies). On the basis of the questionnaire responses, or, in the absence of adequate information from a respondent, the best information available to it (which may be information supplied by the petitioner), the ITA determines on a preliminary basis whether the foreign goods are being sold in the United States at less than fair value or have been subsidized. It does so by calculating the preliminary subsidy margin or dumping margin (i.e., the difference between the U.S. price and the foreign market value of the goods in question). In the case of an affirmative determination, the Customs Service is directed to "suspend liquidation" of all subsequent imports of the product in question and to collect a deposit or bond thereon equal to the preliminary margin.[48] Suspension of liquidation means that the final amount of duty owed on the imported goods is held open for later

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(and any association of such importers); and the government of the country where the product is produced or manufactured. Tariff Act of 1930, §771(9)(A)-(B); 19 U.S.C. §1677(9)(A)-(B). For a list of interested parties on the petitioner's side, see note 41 supra.

[46] Tariff Act of 1930, §771(11); 19 U.S.C. §1677(11).

[47] See, e.g., Gray Portland Cement and Cement Clinker from Japan, ITC Investigation 731-TA-461 (Preliminary), USITC Pub. 2297, July, 1990 (separate opinions by Brunsdale, Lodwick, Rohr and Newquist, with Eckes dissenting).

[48] Tariff Act of 1930, §§703(d), 733(d); 19 U.S.C. §§1671b(d), 1673b(d).

determination. A preliminary negative decision does not end the case, however, as the ITA is required to proceed to a final determination.[49]

Between its preliminary and final determinations, the ITA verifies the questionnaire responses, typically by sending ITA personnel to conduct an on-site examination of the books and records of the respondent. In addition, both the respondent and the petitioner typically file comments in respect of the preliminary determination. In its final determination, the ITA responds to these comments and revises its preliminary determination in light of those comments that it accepts and whatever additional relevant information has come to its attention.

The contested issues and interpretative questions that arise in the course of the ITA's investigation are resolved at various levels within the ITA, depending on the importance of the issue and the "access" that the party (or party's counsel) has to senior ITA officials.[50] Simple matters may be handled by the analyst assigned to a case, more difficult issues may rise to the level of program manager, division director, director of one of the Offices of Investigations, the Deputy Assistant Secretary for Investigations, or even to the Assistant Secretary for Import Administration (or his deputy) before a final decision is reached. In addition to the foregoing individuals, who are in the direct chain of command in an investigation, personnel from the Office of the Chief Counsel for Import Administration, the Office of Policy and the Office of Accounting may be involved, depending on the nature of the issue presented for decision. The number of ITA personnel involved in an investigation depends on the complexity of the case. In major cases, many people are involved. For example, a 1990 case involving sweaters from several East Asian countries involved 14 analysts, 3 program managers, and 1 division director, as well as personnel from the policy, accounting and legal offices.

As noted above, the ITA gathers information from the foreign producers, exporters, and importers through questionnaires and on-site verification visits. Representatives of U.S. industry are not present at the verification visits. Most of the information received by the ITA comes through the questionnaires, verification visits, and briefs and arguments submitted to it by the parties in the case. The statute provides for formal hearings in ITA proceedings to be held prior to the ITA's final determination upon the request of any party,[51] but as discussed below,[52] such hearings are typically pro forma, held late in the proceeding and do not play a major role in the information-gathering process or in developing the legal arguments made in a case.

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[49] The ITA occasionally reaches an affirmative final determination in cases where the preliminary determination was negative. See, e.g., Iron Metal Castings from India, 46 Fed. Reg. 28463 (1981)(negative) & 46 Fed. Reg. 39869 (1981)(affirmative); Nitrocellulose from France, 47 Fed. Reg. 57308 (1982)(negative) & 48 Fed. Reg. 21615 (1983)(affirmative).

[50] The ITA is required to maintain a record of ex parte contacts concerning factual information. 19 CFR §353.35. In practice, records of all ex parte contacts are kept.

If the ITA makes an affirmative preliminary dumping or subsidy determination, the ITC commences a further investigation into the injury issue. Generally, according to ITC officials, to avoid unnecessary work in the event of a preliminary negative determination by the ITA,[53] the ITC does not work on a matter between its preliminary injury determination and the ITA's preliminary determination (115 days in an AD case; 40 days in a CVD case). In the final ITC investigation, a preliminary ITC staff report on the injury issue is made available to the parties shortly after the ITA's final determination. Thereafter, a hearing is typically scheduled, at which the parties can present witnesses and legal arguments.[54] Provision is made for pre- and post-hearing briefs. As a consequence of recent statutory changes, there has been a significant expansion in the parties' access under protective order to the confidential information on which the ITC bases its decision.[55] The ITC's hearing is typically held about 2 or 3 weeks after the ITA's final determination, which gives the ITC 3 or 4 weeks to reach its decision and issue its final report.

Assuming that the ITC makes an affirmative injury finding, an AD or CVD order is issued. The dumping or subsidy margin established in the ITA's final determination is used as the basis for establishing the precise amount of AD/CV duties owed on imports of the merchandise made between the preliminary AD/CVD determination and the final ITC injury determination. If the amount fixed in the final ITA determination exceeds that of the preliminary ITA determination, the shortfall is disregarded; if the final amount is less than that established in the preliminary determination, the excess is refunded, without interest.[56] With respect to imports of the merchandise made after the issuance of an AD or CVD order, a duty equal to the final dumping or subsidy margin is collected provisionally as an estimated AD or CV duty. This provisional amount must normally be deposited with the U.S. government in cash. The final amount of duty owing on these imports is determined in the annual review procedure discussed below.

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[51] Tariff Act of 1930, §774; 19 U.S.C. §1677c. Such hearings are not conducted pursuant to the Administrative Procedure Act (APA).

[52] See Section III.A.3.a. at page infra.

[53] In respect of cases disposed of in 1989, there was 1 ITA negative AD preliminary determination (out of 40 total) and 2 ITA negative CVD preliminary determinations (out of 10). ITC 1989 Report, supra note 15, Tables A-26 & A-28. The comparable numbers for 1990 were 0 of 28 (AD) and 1 of 6 (CVD). ITC 1990 Report, supra note 15, Tables 19 & 21.

[54] This hearing is not conducted pursuant to the Administrative Procedure Act (APA).

[55] See Tariff Act of 1930, §777(c), 19 U.S.C. §1677f(c). Access to such information was the subject of Conference Recommendation 84-6. See supra note 1.

[56] Tariff Act of 1930, §§707(a), 737(a), 19 U.S.C. §§1671f(a), 1673f(a).

It is possible under the AD or CVD statute for the foreign exporters or government to "settle" a case by agreeing to cease dumping, to cease subsidization or to revise their prices so as to eliminate the injury to U.S. industry.[57] Such settlements, known as price undertakings in the GATT Codes and suspension agreements in U.S. law, are common in the EC and to a lesser extent in Australia and Canada, but not in the United States.[58] As of December 31, 1990, there were 5 AD suspension agreements and 12 CVD suspension agreements in effect in the United States.[59]

The principal reason that suspension agreements are not often used in the United States is that Congress has attached many conditions to their use. Under U.S. law, for a suspension agreement to be entered into, (i) exporters of substantially all investigated products must agree to stop exporting to the United States or agree to eliminate completely the dumping margin by raising their prices[60] or (ii) they must agree to revise their prices so as to eliminate completely the injurious effect of exports to the United States.[61] Use of the latter type of agreement is subject to a number of additional conditions and may be entered into only in "extraordinary circumstances". Moreover, the

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[57] Tariff Act of 1930, §§704, 734; 19 U.S.C. §§1671c, 1673c. The GATT Antidumping and Subsidies Codes provide for the settlement of AD and CVD cases through the use of price undertakings. Antidumping Code, supra note 11, art. 7; Subsidies Code, supra note 12, art. 4(5)-(7).

[58] Reports submitted to the GATT Committee on Antidumping Practices for the period July 1, 1986 to June 30, 1990 show the following:

| Country | Undertakings Accepted |
|---|---|
| Australia | 10 |
| Canada | 8 |
| EC | 32 |
| US | 2 |

Source: GATT, Basic Instruments and Selected Documents, 35th Supp., at 354, 359-361 (1989); id., 36th Supp. 439 (1990); id., 37th Supp. 301 (1991). Steele states that undertakings are in fact used "quite often" in Australia. Steele, infra note 135, at 271.

[59] 1990 ITC Report, supra note 15, Tables A-20 & A-22.

[60] Tariff Act of 1930, §734(b); 19 U.S.C. §1673c(b).

[61] Tariff Act of 1930, §734(c); 19 U.S.C. §1673c(c).

legislative history of the U.S. law indicates considerable congressional opposition to use of suspension agreements.[62] This antipathy towards price undertakings seems to have originated in congressional dissatisfaction with the administration of the U.S. AD and CVD laws by the Treasury Department. Congress apparently believed that the Treasury Department imposed duties too infrequently and tended to resolve cases on terms that were too favorable to exporters.

Finally, one important procedural aspect of U.S. AD/CVD proceedings must be highlighted. Much of the information collected by the ITA and ITC is viewed by the suppliers as highly sensitive commercial information, such as detailed data on costs, prices, and customers. While such information is treated as confidential by the agencies and is not available to the public or parties generally, it is available to attorneys for the parties under protective orders.[63] This practice allows attorneys for the parties to participate much more effectively in the proceedings than would be the case if there was no access to such confidential information.

## 2. Administrative Reviews

As explained above, the dumping or subsidy margin determined by the ITA in its final determination in an investigation is used to set the amount that must be deposited on importation of products subject to an AD or CVD order.[64] The ITA, at the request of an interested party, will conduct a review each year to establish the exact extent of dumping or subsidization, and the importer either receives a refund if the amount deposited was too high (plus interest) or pays an additional sum (plus interest) if it was too low.[65] Commerce Department officials told us that such a request is received in approximately 50 to 60% of the cases. Inthose cases where no review is requested, the amount deposited as the estimated duty is collected as the definitive amount due. In the other cases, reviews are held.

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[62] According to the legislative history:

> The suspension provision is intended to permit rapid and pragmatic resolutions of countervailing duty cases. However, suspension is an unusual action that should not become the normal means of disposing of cases....For this reason, the authority to suspend investigations is narrowly circumscribed.

S. Rep. No. 249, 90th Cong., 1st Sess. 54 (1979). For similar language concerning AD suspension agreements, see id. at 71. See generally Holmer & Bello, *U.S. Import Law and Policy Series: Suspension and Settlement Agreements in Unfair Trade Cases*, 18 INTL. LAW. 683 (1984).

[63] 19 CFR §207.7 (ITC); 19 CFR §§353.34 (ITA dumping), 355.34 (ITA countervail), 354.1-.17 (ITA sanctions for violating protective orders). The ITC protective order procedure was the subject of an earlier recommendation by the Conference. See note 1 supra.

[64] The AD statute provides a procedure by which a quick review may be conducted within 90 days after the issuance of an AD order to establish the amount of estimated duties to be deposited on the basis of import transactions made between the date of the preliminary ITA determination and the final ITC determination. Tariff Act of 1930, §736(c); 19 U.S.C. §1673e(c). In theory, this would allow a company found to have engaged in dumping to stop immediately after the preliminary determination and have its deposit rate reflect its cessation of dumping. According to ITA officials, this procedure, which is discretionary on the part of the ITA, is virtually never used.

Reviews are performed by the ITA's compliance office, which is administratively distinct from the office that handles investigations. Essentially the same sort of information is collected in a review as in the initial investigation. There are, however, some differences in the practices of the two offices on the same issues. There are no strict statutory time limits for completion of reviews, and historically, the ITA has had a considerable backlog of reviews waiting to be processed, although it has made progress in reducing that backlog in the recent past.

## 3. Revocation

AD and CVD orders remain in effect until they are revoked. Even if an annual review finds no dumping or subsidization, which means that no amount is required to be deposited on future importations, the AD/CVD order remains in effect and it is possible that a subsequent review could result in the assessment of AD or CV duties. Revocation of an AD or CVD order may occur on a number of grounds: (i) an absence of dumping or subsidization, (ii) an absence of continuing injury, (iii) a lack of continuing interest in a case by domestic industry, and (iv) application of the automatic revocation provision, the so-called "sunset" rule.[66] These procedures are described in the following paragraphs.

> First, a person subject to an AD order may request that the order be revoked on its third or any subsequent anniversary on the grounds that the person has not engaged in dumping

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[65] Tariff Act of 1930, §737(b); 19 U.S.C. §1673f(b).

[66] See generally Shambon, "Revocation Under the Antidumping and Countervailing Duty Laws? You Should Live So Long!," in The Commerce Department Speaks 1987 (volume 2) 241 (PLI 1987); Carreau, "Revocation of Antidumping and Countervailing Duty Orders: New Procedures and Recent Trends in Commerce Practice," in The Commerce Department Speaks 1990 (volume 2) 43 (PLI 1990). Prior to 1989, revocation was also possible where there had been no shipments, which was the second most frequent ground for revocation in AD cases. Carreau, supra, at 86-88; Shambon, supra, at 281.

for at least the last 3 years and will not do so in the future.[67] The request for revocation is treated as a request for an annual review and one is conducted in accordance with normal review procedures, with the additional requirement that the ITA must verify the results of the review.[68] This provision has been the most common ground for revocation since 1980, although it should be noted that in most cases revocation was not opposed by U.S. industry.[69] If U.S. industry is opposed to revocation, the foreign exporters are likely to find it much harder to establish that they will not resume dumping, which is by its very nature a speculative argument.[70] In the case of a CVD order, revocation under similar grounds is possible if the country in question has eliminated the subsidy program found to be countervailable for 3 years[71] or an individual company has not applied for or received any net subsidy for five years.[72]

Second, there is a statutory provision for review of the injury determination by the ITC.[73] If the ITC concludes that revocation would not result in material injury to U.S. industry, the ITA will revoke an AD or CVD order. Such reviews by the ITC are only rarely conducted and only a handful have succeeded.[74]

Third, an AD or CVD order may be revoked on the basis of changed circumstances.[75] The specific circumstance mentioned in the regulations is a lack of interest in the matter

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[67] 19 CFR §353.25(b). If the AD order is to remain outstanding because not all persons covered by it are eligible for revocation, then the person seeking revocation must agree to the immediate reinstatement of the order if it is later found to have engaged in dumping.

[68] The verification procedure typically involves an on-site inspection of a respondent's records to verify that the data submitted to the ITA is accurate. The ITA does not always conduct such inspections in connection with annual reviews.

[69] Shambon, supra note 66, at 278-280.

[70] Carreau, supra note 66, at 67-80.

[71] 19 CFR §355.25(a)(1).

[72] 19 CFR §355.25(a)(2)-(3).

[73] Tariff Act of 1930, §751(b); 19 U.S.C. §1675(b).

[74] See Carreau, supra note 66, at 107-113. (The article notes that there have been 14 cases since 1980, two of which resulted in revocation of an AD order in 1980 and 1981 and two of which led to certain products being excluded from the relevant AD order in 1981 and 1987.)

> by U.S. industry and most revocations under this provision have been based on such lack of interest.[76] For example, orders in 40 steel cases (17 dumping and 23 countervailing) were revoked on this ground in 1985 and 1986.[77] The extent to which a segment of the U.S. industry can prevent revocation on this ground is somewhat unsettled.[78]
>
> Finally, revocation is possible if there has been no request for an annual review for four consecutive anniversaries of an order and if after notice to all interested parties, no one objects to revocation on the fifth anniversary.[79] This provision was added to the AD regulations in 1989 (and to the CVD regulations in late 1988), and there has been little experience under it to date. Its effect may be limited since revocation is unlikely to occur if there is any objection at all from U.S. industry.[80]

From the foregoing description, it seems reasonable to conclude that revocation is relatively rare unless there is no opposition from U.S. industry. In the 3 years 1988-1990, there were a total of 15 AD order revocations (197 AD orders remained outstanding at the end of 1990, compared to 163 at the end of 1988) and 13 CVD order revocations (72 CVD orders remained outstanding at the end of 1990, compared to 77 at the end of 1988).[81] This means that the unsettling effect on international trade inherent in a U.S. AD or CVD order typically continues for a considerable period of time.[82]

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[75] 19 CFR §§353.25(d), 355.25(d).

[76] Carreau, supra note 66, at 89.

[77] Id. at 90.

[78] Id. at 90-97; Oregon Steel Mills v. United States, 862 F.2d 1541 (Fed. Cir. 1988).

[79] 19 CFR §§353.25(d)(4), 355.25(d)(4).

[80] According to Shambon, out of 34 notices of intent to revoke issued, there were 15 revocations. Shambon, Speech to Federal Circuit Judicial Conference, Washington DC, May 9, 1991.

[81] ITC Report 1990, supra note 15, Tables A-20 & A-22; ITC 1989 Report, supra note 15, Tables A-27 & A-29; ITC 1988 Report, supra note 15, Tables B-20 & B-22.

[82] As of December 31, 1990, the then outstanding AD and CVD orders had originally come into effect as follows:

| Year | Number of Orders Outstanding | |
|---|---|---|
| | AD | CVD |
| 1990 | 14 | 2 |
| 1989 | 32 | 6 |

## 4. Judicial Review

U.S. law provides for appeals from final determinations of the ITA or ITC to the Court of International Trade a specialized, Article III court that hears only cases involving international trade issues, principally customs questions (classification, valuation, and origin) and trade remedies (antidumping and countervailing duties).[83] The standard of review is specified in the statute. Decisions by the ITA not to initiate an investigation and negative preliminary decisions by the ITC are reviewed to see if they are "arbitrary, capricious, or an abuse of discretion, or otherwise not in accordance with law."[84] Final determinations by the ITA and the ITC are reviewed to see if they are "unsupported by substantial evidence on the record, or otherwise not in accordance with law."[85] From the CIT, cases are appealable to the Court of Appeals for the Federal Circuit, and to the Supreme Court on writ of certiorari. Decisions involving Canadian products may instead be "appealed" to binational panels under the United States-Canada Free Trade Agreement.

Prior to 1979, the law relating to judicial review in AD/CVD cases was different and there was relatively little judicial review of such cases.[86] Now, judicial review is much more common, and it appears that most AD and CVD

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| | | |
|---|---|---|
| 1988 | 12 | 3 |
| 1987 | 38 | 16 |
| 1986 | 23 | 10 |
| 1985 | 7 | 11 |
| 1980-84 | 30 | 17 |
| 1975-79 | 18 | 7 |
| 1970-74 | 20 | |
| pre-1970 | 3 | |

ITC 1990 Report, supra note 15, at Tables A-20 & A-22.

[83] Tariff Act of 1930, §516A; 19 U.S.C. §1516a. Approximately one-half (46.3 percent) of the CIT's cases in the January 1986 to September 1989 period involved AD or CVD appeals. Shambon, *Accomplishing the Legislative Goals for the Court of International Trade: More Speed! More Speed!*, 14 FORDHAM INTL. L. J. 31, 31 (1990-1991). The AD and CVD cases are probably in the main much more complicated than the typical customs law cases in the CIT.

[84] Tariff Act of 1930, §516A(b)(1)(A), 19 U.S.C. §1516a(b)(1)(A). This standard also applies to refusals by the ITC to conduct a changed circumstances review under section 751.

[85] Tariff Act of 1930, §516A(b)(1)(B); 19 U.S.C. §1516a(b)(1)(B). Appeals to which this standard is applicable include appeals of final dumping and subsidizations determinations by the ITA, final injury determinations by the ITC, final determinations by the ITC in changed circumstances review under section 751 and final determinations by the ITA or ITC in connection with the suspension of an AD or CVD investigation

[86] Horlick, supra note 28, at 130.

final determinations are appealed to the CIT.[87] As the system of judicial review has developed in the last decade, it has been held that decisions of the CIT are generally not appealable to the Federal Circuit if the CIT decision involves a remand to the ITA or ITC.[88] The result is that cases usually reach the Federal Circuit only after considerable time has elapsed because the CIT, on average, takes many months to review a case and it frequently remands a case to the ITA or ITC. Indeed, in some cases there is more than one remand.

A recent study found that cases in the CIT took the following amount of time for consideration of the first appeal in AD and CVD cases:[89]

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[87] With respect to the ITC, roughly two-thirds of appealable decisions are appealed, and the 1988 trade legislation may increase that percentage. Toupin, *The Court and the Commission After Ten Years: A Personal View,* 14 FORDHAM INTL. L. J. 10, 30 (1990-1991). We suspect that similar statistics apply for ITA determinations.

[88] Cabot Corp. v. United States, 788 F.2d 1539 (Fed. Cir. 1986).

[89] Shambon, supra note 83, at 46. The author recently reported that the 17 1990 CIT decisions he had examined had a median disposition time of 29 months. Shambon, supra note 80.

| Year of CIT Opinion | Number of Cases | Median Time to Issuance of Opinion |
|---|---|---|
| 1986 | 17 | 20 months |
| 1987 | 29 | 24 months |
| 1988 | 39 | 21 months |
| 1989(3Q) | 27 | 24 months |

In examining a sample of these cases, the author found that the median time (20 months in his sample) was split into the following four components:[90]

| Procedural stage | Actual | Standard |
|---|---|---|
| Filing of complaint to filling of record | 2 months | 2 months |
| To plaintiff's motion for judgement | 6 | 4 1/2 |
| To filing of last brief/last argument | 7 | 3-3 1/2 |
| To opinion | 5 | 4-4 1/2 |
| Total | 20 | 13 1/2 to 14 1/2 |

These times are in contrast to what the author calls the "standard" times based on CIT rules or his estimates of a reasonable time for the phase in question. As the statistics indicate, the main delays occur in middle of the process.

Moreover, the above statistics do not tell the whole story because approximately one-half of the cases result in a remand to the agency.[91] The median time for disposition of a remand in the 1986-1988 period (46 instances) was 6 months (the average was 8.4 months).[92] Thus, in a significant number of cases (i.e., one-half of those appealed), there is no final disposition, on average, for 2 1/2 to 3 years after the administrative determination--a rather striking contrast to the tight investigative timetables. Moreover, some cases continue beyond a first remand. In the 1986-1988 period, there were 12 cases remanded for a second time, and the median time for disposition on the second remand was 5 months (the average time was 7.2 months).[93]

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[90] Shambon, supra note 83, at 45, 47.

[91] Id. at 48. These figures are for all 112 decisions considered. The percentage remanded varied as follows: 1986 - 41.2 percent; 1987 - 51.7 percent; 1988 - 59.0 percent; 1989(3Q) - 29.6 percent. Id. It was approximately 50 percent for 1990 as well. Shambon, supra note 80.

[92] Shambon, supra note 83, at 48.

In short, the process of judicial review in the CIT often takes years. This is true despite a perception, at least on the part of the agencies, that CIT review does not cause them to change their results significantly. For example, in the case of appeals from ITC decisions, the ITC rarely reverses its decision on remand.[94] In the case of the ITA, remands are more common and do often result in some change in duty rate, but it is our impression from talking to present and former ITA officials that in most cases CIT review has not resulted in significant changes in ITA determinations. Thus, the long wait for CIT decisions may not lead to significant changes in results, even if a remand is obtained.

## B. The EC, Canadian, and Australian Experiences: Lessons for the United States?

In this section, we will not describe in any detail the AD/CVD systems in the European Community (EC), Canada, or Australia.[95] In many respects the systems operate in much the same way, which is not surprising given that they apply more or less the same substantive rules. There are some procedural differences, however, and in this section, we will attempt to point out the more salient ones.

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[93] Id. at 19.

[94] Toupin, supra note 87, at 25.

[95] See generally J. Jackson & E. Vermulst, supra note 28; General Accounting Office, International Trade: Comparison of U.S. and Foreign Antidumping Practices (GAO/NSIAD-91-59, Nov. 1990) [Hereinafter "GAO Report"]. The GAO Report analyzes EC, Canada and Australian practices in some detail in respect of procedures for initiating cases, general transparency and rights of appeal. The report contains more limited information on these issues under the new Mexican AD law. In addition, it describes briefly the as yet seldom used AD laws of Brazil, India, Japan and South Korea.

## 1. The EC System

Under the EC antidumping rules,[96] the investigation is conducted by one agency--a division of the External Affairs Directorate of the EC Commission--that examines both the dumping and injury aspect of each case.[97] In the EC a case is commenced when the EC initiates an investigation. The EC acts on complaints filed by EC industry, but it is not required to initiate a case unless it is satisfied with the complaint.[98] Consequently, it has considerable discretion over the initiation of cases. In deciding whether to initiate a case, the EC apparently focuses more (compared to the United States) on the injury issue than on the dumping issue, because it believes that the complaining industry has more reliable data on that issue.[99] Except for the goal of processing cases within a 1-year period, the EC is not subject to time limits for completing various aspects of the case.[100]

In processing cases, the EC utilizes the same basic procedures as are followed in the United States--it sends out questionnaires and later verifies the responses. In dealing with the parties, however, it uses much more informal procedures. For example, most contact with the EC authorities is through ex parte contacts with the casehandlers and formal hearings are generally not held.[101] Moreover, because of the EC confidentiality rules, much of the most important information filed in a case is not subject to review by the parties or their attorneys because there is no provision for access to such information under protective order, such as in the United States.[102] Even more critically, the Court of Justice of the EC has not examined AD cases in any depth; it tends only to verify that the general terms of the EC rules were followed. While this has meant that the EC authorities are now careful to follow the letter of their own procedures, challenges to the detailed calculations of dumping margins have not been closely reviewed by the Court.[103] Moreover, review in the Court has been very time consuming.[104]

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[96] The EC antidumping rules are found in Council Regulation (EEC) 2423/88 of July 11, 1988, which was published in EUR. COMM. O.J. No. L 209/1 (August 2, 1988)[Hereinafter "EEC Regulation"].

[97] For a concise general description of the EC system, see Bellis, The EEC Antidumping System, in J. Jackson & E. Vermulst, supra note 28, at 41-97. The EEC Regulation, supra note 96, also deals with CVD cases, but as a general matter the EC seldom brings such actions. When it does, it follows the same procedures with respect to them as it does in AD cases.

[98] See EEC Regulation, supra note 96, arts. 5(5), 7(1).

[99] GAO Report, supra note 95, at 21.

[100] EEC Regulation, supra note 96, art. 7(9)(a).

[101] There is provision for a so-called confrontation hearing at which EC officials listen to arguments made by both parties, but these are not often held and are not generally useful because most factual information cannot be discussed since it is treated as confidential, although they have become somewhat more common in recent years. See Bellis, supra note 97, at 49-50. The GAO found that they were seldom held. GAO Report, supra note 95, at 28-29.

[102] This situation may change, as the Court of Justice recently overturned a Community antidumping order on the grounds that the Commission had failed to disclose information to a respondent that the Court thought was necessary to enable the respondent to defend itself. Al-Jubail Fertilizer Co. v. Council, Case C-49/88, [1991] ECR--(June 27, 1991). It is not yet

The results of dumping cases in the EC are much different than in the United States. The amount of the duty imposed is not necessarily the amount of the dumping margin. The EC authorities have the discretion to impose a lesser duty if such would be sufficient to eliminate the injury to EC industry.[105] This practice is referred to as using "injury margins" or a "lesser duty rule" and a significant proportion (roughly 50 percent) of EC AD duties are based on such analysis.[106] Moreover, the EC is required to take into account the "Community interest" in imposing duties,[107] although this provision is not typically applied to reduce duties as the EC authorities seem to equate Community interest with complainant (and not consumer) interests in most cases.[108]

If duties are ultimately imposed in the EC, they are imposed on a prospective basis.[109] There is no annual review to determine the precise amount of the dumping margin for each transaction. There is the possibility of obtaining a refund if no dumping in fact occurred in a given transaction,[110] but because of procedural and substantive impediments, refunds are rare.[111] After 1 year has passed, it is possible to ask that the duty rate be reviewed.[112] In practice, the review possibility is apparently not an effective way to seek a change in an EC AD duty, although some reviews are held and result in lower

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clear how the Commission will change its procedures on disclosing information to meet the Court's concerns in this case.

[103] In 1991, the Court of Justice was somewhat more thorough in reviewing EC AD cases. See, e.g., Al-Jubail Fertilizer Co. v. Council, Case C-49/88, [1991] ECR--(June 27, 1991); Nolle v. Hauptzollamt Bremen-Freihafen, Case C-16/90, [1991] ECR--(October 22, 1991). Whether this trend will continue is unclear.

[104] See Bellis, supra note 97, at 67-68; GAO Report, supra note 95, at 41-42.

[105] EEC Regulation, supra note 96, art. 13(3).

[106] Bellis, supra note 97, at 57.

[107] EEC Regulation, supra note 96, arts. 11(1), 12(1).

[108] Bellis, supra note 97, at 62-63.

[109] See EEC Regulation, supra note 96, art. 13.

[110] EEC Regulation, supra note 96, art. 16.

[111] Bellis, supra note 97, at 60-61.

[112] EEC Regulation, supra note 96, art. 14.

rates.[113] After 5 years, an EC AD duty expires unless "an interested party shows that the expiry of the measure would lead again to injury."[114] In that case, the EC conducts a review of the measure and decides whether it should be extended. A considerable number of old measures have consequently been abrogated as a result of this rather new procedure, but at least some experts are uncertain whether it will have any long-term beneficial effect since the procedure occasionally leads to renewed interest in cases that have otherwise been forgotten, especially when Community industry decides to oppose the expiration as a matter of course.[115] Our impression from speaking to attorneys practicing before the EC is that Community industry can usually successfully oppose revocation if it merely alleges that although it is doing better, removal of the duties will result in increased imports and make it worse off.

Generally speaking, for a businessman, the prospect of a fixed prospective duty is disturbing. Even if one stops dumping, the duty may continue to be payable. To avoid this kind of duty, companies subject to EC investigations typically have made so-called price undertakings,[116] pursuant to which they "settle" the case by agreeing to respect certain price levels in their exports to the EC and to report their prices to the EC regularly.[117] From 1980 to 1989, of those cases in which dumping and injury were found, 183 cases (66 percent) were concluded by undertakings, while in 96 cases (34 percent) duties were imposed.[118] No undertakings were accepted in 1988,[119] partly because of Community political concerns with Japan--a major target of EC AD actions, as well as worries about the enforceability of the undertakings, particularly in respect of product areas characterized by rapid model changes.[120]

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[113] Bellis, supra note 97, at 63-64. The GAO found that administrative reviews in the EC were not often sought because of various disincentives. See GAO Report, supra note 95, at 37.

[114] EEC Regulation, supra note 96, art. 15(3).

[115] See Bellis, supra note 97, at 64-65.

[116] The term "price undertaking" appears in Article 7 of the GATT Antidumping Code, supra note. Similar settlements are possible, although rare, under U.S. law where they are called suspension agreements. The U.S. practice with respect to suspension agreements is described in the text accompanying page supra.

[117] See EEC Regulation, supra note 96, art. 10.

[118] Commission of the European Communities, in The Financial Times, April 17, 1991, at 6.

[119] Commission of the European Communities, Seventh Annual Report of the Commission on the Community's Anti-Dumping and Anti-Subsidy Activities, at Annex O (COM(90)229, June 13, 1990). Actually several undertakings were accepted, but duties were imposed anyway.

[120] Bellis, supra note 97, at 52-53.

Undertakings remain a major feature of EC practice, however, and eight were accepted in 1990.[121]

A comparison of the EC system to the U.S. system suggests a number of conclusions in respect of fairness and efficiency. First, as to fairness, there are fewer institutional safeguards against bias in the EC system. There is only one level of judicial review, and as long as the EC follows the proper procedures, experience suggests that judicial review in the EC Court of Justice will be pro forma. In addition, because the lawyers involved in EC cases have access to much less information than do lawyers in the United States (confidential information has historically not been revealed), they are less able to argue their clients' cases effectively.

Second, as to efficiency, the EC procedures seem to be much less costly than those in the US. To begin with, many cases are settled, which eliminates several stages of a typical proceeding. In addition, the prospective nature of the duty eliminates from an EC proceeding the entire cost associated with annual reviews in the United States (except to the limited extent that refunds are requested or reviews conducted in respect of the prospective rate). Finally, the nature of EC judicial review means that there will at most be one appeal and it will probably fail, whereas in the United States, the appellate process is often lengthy, and therefore much costlier, but at the same time more likely to lead to at least some changes in the administrators' decisions.

## 2. The Canadian System

The Canadian system[122] seems to operate more like the U.S. system than the EC system. Among the Canadian system's similarities with the U.S. system are strict time limits,[123] a bifurcated dumping and injury investigation[124] and extensive access under protective order to the confidential information of all parties in proceedings before the Canadian International Trade Tribunal (the body charged with determining the injury issue).[125]

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[121] Commission of the European Communities, Ninth Annual Report of the Commission on the Community's Anti-Dumping and Anti-Subsidy Activities (1990), at 47, Annex D (SEC(91)974 final, May 31, 1991).

[122] See generally Magnus, The Canadian Antidumping System, in J. Jackson & E. Vermulst, supra note 28, at 167-223. The relevant statute is the Special Import Measures Act, R.S., 1985, c. S-15, as amended by R.S. 1985, c. 23 (1st Supp.), R.S. 1985, c. 1 (2d Supp.), R.S. 1985, c. 47 (4th Supp.) and 1988, c. 65 (Hereinafter "SIMA").

[123] SIMA, supra note 122, §§31, 38, 41, 43.

[124] The dumping investigation is conducted by Revenue Canada (Department of National Revenue, Customs and Excise) and the injury determination is made by the Canadian International Trade Tribunal.

[125] Magnus, supra note 122, at 179.

Compared to the EC, there is a relatively limited use of undertakings, although Canada appears to use undertakings more frequently than the United States.

There are, however, some significant differences between the Canadian and the U.S. systems. First, as in the case of the EC, there seems to be relatively limited judicial review, particularly of the findings of the Canadian International Trade Tribunal, which determines the injury issue.[126] As to dumping issues, appeals of Revenue Canada decisions can be made to the Federal Court on questions of law.[127] One Canadian official estimated that perhaps 5 to 10 percent of dumping assessments were appealed.[128] Second, hearings before the Tribunal are more formal than those held in the United States, as the opposing parties present evidence and witnesses, who are subject to cross-examination.[129] Third, the Tribunal may consider whether an AD/CV duty would be in the public interest, and may recommend to the relevant Minister that duties should not be imposed or should be reduced.[130] To date, it appears that such recommendations have been made only rarely.[131]

Fourth, if dumping and injury are found, Revenue Canada usually sets the normal value for the product in question by establishing a so-called benchmark price. Future imports at less than the benchmark price are subject to a duty in the amount of the shortfall.[132] Thus, as in the EC system, there is a prospective duty, but like the U.S. system, if the exporter stops dumping, there is usually no duty due. According to Canadian officials to whom we spoke, the principal exception to the use of benchmark prices is that in respect of certain products for which it is difficult to establish benchmark prices (e.g., apparel or footwear products, which are in fashion for only a few months, products that are sold in a multitude of models or by an uncooperative exporter), prospective ad valorem duties are used, as in the EC. Reviews of the benchmark prices are conducted more or less annually.[133] There is a 5-year sunset provision under which duties expire unless the Tribunal finds that dumping and injury would result if they are not continued.[134]

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[126] Magnus, supra note 122, at 175-176. The Tribunal's decisions on injury questions are deemed to be "final and conclusive." SIMA, supra note 122, §76.

[127] SIMA, supra note 122, §62.

[128] Magnus reports, however, that only a very few such appeals have occurred in the past. Magnus, supra note 122, at 180 n. 51 & 221 n. 206.

[129] Magnus, supra note 122, at 179.

[130] SIMA, supra note 122, §45(1).

[131] Magnus, supra note 122, at 190-191.

[132] Magnus, supra note 122, at 191.

[133] Magnus, supra note 122, at 192. The GAO Report confirms that reviews are conducted frequently. GAO Report, supra note 95, at 36.

[134] SIMA, supra note 122, §76(5).

On the question of fairness, the Canadian system appears to lack the intrusive judicial review that is the hallmark of the U.S. system, although the Canadian system, with its more extensive formal injury hearings by an independent tribunal (which also hears dumping assessment appeals), seems to be a fairer system than that provided by the EC. As to efficiency, the use of benchmark prices seems to be less trade disruptive and less costly than the practice in the United States of conducting annual reviews, although there are periodic reviews of the benchmark values in Canada, apparently on an annual basis, and setting those values can be a complex process.

### 3. The Australian System

Under the Australian system,[135] the Australian Customs Service is charged with investigating allegations of dumping pursuant to a statutory timetable.[136] Affirmative determinations by the Service are referred to the Anti-Dumping Authority (ADA), an independent agency, which makes a further inquiry into the matter and recommends to the relevant Minister whether AD duties should be imposed.[137] According to ADA officials, in its inquiry the ADA reviews the Customs Service file in the matter and often gathers additional data. It asks for comments from the interested parties and encourages parties to meet with it, although confidential information of other parties is not revealed. In making its inquiry, the ADA is directed to solicit comment from the public and is accordingly able to consider the national interest in its recommendations to the Minister.[138] Judicial review of the imposition of AD duties is possible under Australian law and sufficient reversals of agency decisions have occurred to have had an effect on administrative practices.[139] It is our impression, however, that judicial review is less frequent and much less intrusive than in the United States.[140]

Antidumping cases in Australia are often settled by undertakings.[141] When AD duties are imposed, they are normally set prospectively through the use of

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[135] See generally Steele, The Australian Antidumping System, in J. Jackson & E. Vermulst, supra note 28, at 223-286.

[136] Customs Legislation Act, §§269 TC, TD.

[137] Anti-Dumping Authority Act 1988, §7(1). The ADA also considers appeals of negative dumping and injury determinations by the Australian Customs Service. Id., §8,

[138] Anti-Dumping Authority Act 1988, §7(5); Steele, supra note 135, at 284.

[139] Steele, supra note 135, at 237-240.

[140] The GAO Report cites Australian experts to the effect that appeals will likely become more common in Australia in the coming years. GAO Report, supra note 95, at 42.

[141] Steele, supra note 135, at 271-272.

NIFOBs--noninjurious FOB values.[142] Under this system, the Australian authorities determine what price would have prevailed in the Australian market in the absence of dumped imports. This is done by examining Australian industry's costs and markups and establishing a price at which Australian industry would not suffer any injury.[143] Using that price, an equivalent FOB price for imports is calculated. Imports at lower FOB prices are subject to duties in an amount equal to the difference between the import price and the applicable NIFOB, provided that a NIFOB cannot be set at a level in excess of the product's normal value. In essence, this means that Australia does have a version of the so-called lesser duty rule.[144] According to Australian Customs Service officials, NIFOBs may be adjusted, if requested, every 12 to 18 months. Finally, under Australian law, AD duties expire, automatically and without review proceedings, after they have been in effect for 3 years.[145]

The Australian procedures resemble those used in the EC and Canada in that price undertakings are common, duties are prospective and judicial review is not particularly intrusive. The ADA procedures with respect to treating confidential information and gathering information from parties seem more like the EC procedures than the U.S. and Canadian ones. One noteworthy and unique feature of the Australian law is the automatic revocation procedure that limits the effective period of an AD duty to 3 years.

**Summary**. The procedures used by these three jurisdictions seem simpler, less time consuming and less expensive than U.S. procedures. To the extent that these advantages are obtained by cutting corners on fairness by providing less judicial review or through the lack of effective party involvement in reviewing data submitted by other parties--the systems may be deficient compared to the U.S. system. On the other hand, it would seem worth exploring whether an increased use of undertakings and prospective duties with limited opportunity for refund or review might offer considerable time and cost savings without reducing the overall fairness of the U.S. system.[146]

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[142] Steele, supra note 135, at 272-273.

[143] If the Australian industry is not making a profit for reasons unrelated to dumped or subsidized imports, the NIFOB level may be based on the industry's actual selling prices. See Australian Anti-Dumping Authority, Bulk Brandy from France 28-35 (Report No. 17, Feb. 1990).

[144] Steele, supra note 135, at 272.

[145] Customs Tariff (Anti-Dumping Act) 1975, §12B; Steele, supra note 135, at 285.

[146] These issues were explored in the preliminary report, but the Committee on Regulation decided not to recommend adoption of any of the changes that we had tentatively suggested in that report.

# III. Reform of Procedures Used in AD/CVD Proceedings

Based on our review of the current procedures used in AD/CVD cases and comments received from administrators and practitioners while drafting this report, we believe that there are four areas where reforms in current procedures could usefully be made. First, we consider improvements in the hearing process before the ITA and the ITC, examining whether it would be desirable to insert administrative law judges (ALJs) into the process and, if not, whether other changes could be implemented to improve the hearings now conducted by those agencies.[147] Second, we analyze a number of cost-saving measures that would reduce parties' expenses in bringing and defending proceedings before the ITA.[148] Third, we turn our attention to the structure of the ITC and consider whether certain changes in its decision-making processes would be desirable. Finally, we examine whether there is a need for two levels of judicial review in AD/CVD cases.

As will become evident in our discussion, our goal is to improve the administrative decision-making process and the overall efficiency of AD/CVD proceedings--the two areas that we felt were of primary concern to those involved in AD/CVD cases.[149] The goal of improving the administrative decision-making process, for example, by making it more accurate and fairer, must be balanced against the goal of efficiency--whatever administrative procedures are used must not take too long and cost too much.[150] The AD/CVD system should obviously not be so costly that some petitioners and respondents cannot afford to participate in proceedings. At the same time, however, it must allow for sufficient investigation and comment so that the results (i.e., the dumping/subsidy margins calculated and the injury determination, are reasonably accurate). The tradeoff between cost and time, on the one hand, and accuracy and fairness, on the other, places a premium on a system that attains reasonable accuracy with minimal costs in a short period.

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[147] The Committee on Regulation decided not to recommend the use of ALJs.

[148] In the preliminary draft of this report, dated February 4, 1991, we made a number of proposals that we believe offer the prospect of significant time and cost savings. These proposals were opposed by the agencies and significant elements of the international trade law bar. Since the Committee on Regulation decided not to endorse them, we do not discuss them in this report.

[149] These goals are similar to those advanced by administrative law scholars for administrative procedures generally. See, e.g., Cramton, *A Comment on Trial-Type Hearings in Nuclear Power Plant Siting*, 58 VA. L. REV. 585, 591-593 (1972) (goals are accuracy, efficiency and acceptability); Verkuil, *A Study of Informal Adjudication Procedures*, 43 U. CHI. L. REV. 739, 740 (1976) (goals are fairness, efficiency and satisfaction to participants).

[150] In considering the costs of the procedures, it is necessary to weigh their trade disruptive effect, as well as the direct out-of-pocket costs and other costs, such as diversion of management and staff time associated with gathering data and participating in the procedures.

## A. Improvements in ITA/ITC Hearings

We examine first whether it would be useful to change the nature of hearings that are now conducted in AD/CVD cases. In examining this issue, we first consider what sort of procedural protections parties ought to have in an administrative process. We then consider the nature of AD/CVD proceedings and how that affects what kind of procedural protections are appropriate. In light of our conclusions, we consider whether the hearings currently conducted by the ITA and the ITC are adequate. In particular, we examine whether the present system could be improved (i) by the insertion of ALJs into the administrative process and (ii) if not, by more limited changes in the conduct of hearings at the ITA and the ITC.

### 1. The Concept of Procedural Fairness

At the outset, it is helpful to focus conceptually on the question of what are the components of procedural fairness. This question has arisen numerous times in U.S. courts, in particular in the context of determining what sort of procedures must be followed by government agencies in dealing with individuals in a wide variety of contexts. One of the more influential federal jurists of recent years, the late Judge Henry J. Friendly, of the Second Circuit Court of Appeals, once listed the basic considerations useful in determining whether parties dealing with the government had received a fair hearing as follows:[151]

1 - An unbiased tribunal

2 - Notice of the proposed [government] action and the grounds asserted for it

3 - An opportunity to present reasons why the proposed action should not be taken

4 - The right to call witnesses

5 - The right to know evidence against one, perhaps including the right to cross-examine adverse witnesses

6 - The right to have the decision based only on the evidence presented

7 - Counsel

8 - The making of a record of the evidence presented

9 - A statement of reasons [for the decision]

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[151] Friendly, *Some Kind of Hearing*, 123 U. PA. L. REV. 1267, 1279-1295 (1975).

10 - Public attendance
11 - Judicial review

These factors were not presented as immutable requirements, but only guidelines for evaluating a specific process. Indeed, Judge Friendly stressed that some may be unnecessary depending on the nature of the proceeding, particularly if there is an unbiased decisionmaker.

For our purposes, these factors can be usefully divided into three categories:[152] (i) the opportunity to have a meaningful hearing (which includes the right to receive notice, to present one's own position to the decisionmaker, and to be aware of and able to challenge the opposing evidence and argument--items 2-5, 7); (ii) the right to have a decision made on the record by an impartial decisionmaker--items 1, 6; and (iii) the right to judicial review--items 8-9, 11.[153] If meaningful hearings in AD/CVD cases are held before unbiased decisionmakers, whose actions are subject to effective judicial review, the result should be the sort of predictable, consistent decisions that are essential in international trade matters.

## 2. The Nature of AD/CVD Proceedings: Investigative or Adjudicative?

To evaluate the hearings held in AD/CVD proceedings, one must consider whether those proceedings should be investigative or adjudicative in nature. Is the government's role principally that of an investigator, which collects and weighs evidence and then acts to enforce a statute, or is it mainly that of a judge, essentially ruling on a dispute between two private parties? The answer to this question will have an important impact on how the hearing process is appraised and what changes might be suggested to improve it. At the moment, it seems clear that under the relevant statutes, as interpreted by the courts, the process is primarily an investigative one, although there are clearly aspects of the process that resemble an adjudication.[154] This does not answer the question, however, of whether the process **should** be more or less investigative or adjudicatory. For that answer, it is necessary to examine more closely the nature of these proceedings.

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[152] For a similar categorization, see Cramton, supra note 149, at 588.

[153] We have omitted "public attendance." Because of the volume of confidential information involved, full public participation in proceedings would probably not be desirable. There are, however, timely public notices of actions taken in AD/CVD cases and much information is available in the public record.

[154] See Madaj, *Agency Investigation: Adjudication or Rulemaking?--The ITC's Material Injury Determinations Under the Antidumping and Countervailing Duty Laws*, 15 N. CAR. J. INTL. L. & COMM. REG. 441 (1990).

Governments have traditionally played an investigative role in AD/CVD proceedings. In large part this has been due to the remedy that these laws provide--an increase in customs duties, which only the government can provide. The extensive government involvement in these cases is also a result of history. AD/CVD investigations have traditionally been administrative proceedings. Moreover, the role played by the government has certain advantages to all parties. AD/CVD investigations may be too costly and complex to be undertaken by smaller businesses. If those businesses are not to be effectively excluded from the protections offered by the AD/CVD laws, the government must take the laboring oar in the investigations. Because of the sensitivity of the commercial information that must be analyzed to determine the existence of dumping or subsidization, the exporters may well be more comfortable having the government carry the principal investigative burden in AD/CVD cases. Thus, it has been long-standing practice for government investigators to collect the relevant information, verify it, and then use it to determine whether duties are to be imposed.

The government's investigative role may also be explained by the unusual nature of AD/CVD proceedings. On the one hand, AD/CVD actions are not criminal proceedings; on the other hand, they do not give rise to civil damage actions.[155] (Indeed, often the conduct that leads to imposition of AD/CV duties is not subject to sanction at all in the purely domestic context.[156]) In other words, to view an AD/CVD case as strictly a matter of one company using an unfair trade practice statute against another is not a complete description of what AD/CVD proceedings are about. If that was all there was to it, then perhaps a private damage action could be justified, but the policies are in fact more complex.[157] The harmed domestic industry gets compensation for its injury only in the sense that the duty should offset in the future the challenged trade practices. The remedy is a limited one; the prevailing domestic industry is not guaranteed a remedy that completely offsets its overall injury, but only a remedy that offsets the dumping/subsidization.

The role of the parties cannot be dismissed as merely tangential, however. It is true, of course, that neither the parties nor their attorneys conduct the investigation of the opposing side. While the attorneys see the results of the investigation, subject to a protective order, they do not otherwise participate in it. Nonetheless, by their intervention with the agencies (made more effective because of their access to information), they may considerably influence the direction and scope of the investigation. The parties are, in addition, the source of most of the information collected in the investigation,[158] and they comment extensively on how the AD/CVD rules should be applied to the information in the agencies' hands. Moreover, they are clearly the principal parties in interest. Their businesses will be directly affected by the agencies' decisions, sometimes on a massive scale. Thus, at the base of the investigation is a commercial dispute between private parties, but the government bears the principal responsibility for investigation.

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[155] The 1916 Antidumping Act, 15 U.S.C. §72, makes certain intentional dumping unlawful and provides for a civil treble damage remedy. There are apparently no reported cases of a conviction or civil recovery. J. Jackson & W. Davey, supra note 3, at 800-801.

[156] In some cases dumping would be actionable domestically (that is, one domestic company could sue another) under price discrimination statutes (and in the United States, obtain treble damages). In other cases, an antitrust action might be successfully brought on the grounds of predatory pricing. Such actions appear to be rarely successful. Davey, supra note 4, at 8-17 to 8-21.

[157] It should be noted that a private remedy would almost certainly violate GATT rules.

Moreover, even as now structured, the government's role is not only investigative; it also has an adjudicative aspect. It considers the evidence and the arguments of the parties and decides whether injurious dumping or subsidization has occurred. Because of the importance of these proceedings to the economic interests of the parties, they typically spend large sums on attorneys and other experts, who, in turn, immerse themselves in every detail of these cases.[159] The deep involvement of the parties can be seen in the fact that most of the government's decisions are appealed to the Court of International Trade.[160] As a result, in many respects these proceedings resemble adjudications.

Comments made by the agencies make it clear that they believe that AD/CVD proceedings are and should be solely investigative. Indeed, it would seem from the comments made to us that the agencies to some extent consider the parties and their attorneys to be annoyances as opposed to full participants

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[158] This statement is somewhat less true of the ITC than of the ITA because the ITC contacts nonparties (e.g., customers) for information about domestic industry.

[159] According to a GAO study based on interviews with petitioners' counsel, the average of the average minimum and maximum estimates for attorneys fees in AD and CVD cases were as follows:

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|---|---|---|---|
| AD | $352,000 | CVD | $269,000 |
| AD Reviews | $105,000 | CVD Reviews | $ 95,000 |
| AD Appeals (CIT) | $ 66,500 | CVD Appeals (CIT) | $ 87,500 |
| AD Appeals (FC) | $ 34,000 | CVD Appeals (FC) | $ 42,500 |

U.S. General Accounting Office, International Trade: Pursuit of Trade Law Remedies by Small Business (NSIAD-89-69BR, Dec. 1988). Respondents in a case typically spend much more since each respondent is likely to have separate counsel.

[160] See Section II.A.4. at page supra.

in the process. It seems to us that this attitude is inappropriate. Given the economic interests at stake and the way in which these procedures have evolved over time so as to include extensive involvement by the parties and especially their attorneys, the procedures cannot be considered solely as government investigations where those investigated should speak only when spoken to.

In our view, it is not necessary to believe that these proceedings are solely adjudicative and that the parties should alone bear the burden of establishing their cases without government assistance; to conclude that they are sufficiently adjudicative such that meaningful hearings with appropriate procedural protections should be held by the agencies. We now turn to examine whether that is the case with the present system.

## 3. Evaluation of the Current System

As noted above, there are three basic elements to procedural fairness: a meaningful opportunity to be heard, a decision on the record by an impartial decisionmaker, and an opportunity to obtain court review of that decision. An analysis of the current U.S. procedures suggests that while they in part meet those three criteria, some improvements could be made.

### a. A meaningful hearing

First, with respect to a meaningful opportunity to be heard, we suggested above that such an opportunity included the receipt of notice of government action, the right to present one's own arguments and evidence, and the right to know the opponent's arguments and evidence and to contest them. Under current U.S. law and practice, those parties directly interested in the proceeding have considerable opportunity to present their arguments and contest their opponent's arguments. Under the protective order procedure, their attorneys have relatively detailed knowledge of the opponent's evidence. The ITC conducts a non-APA hearing on the injury issue, at which the commissioners hear some evidence and argument by the parties. In addition, the parties have the opportunity to file pre- and post-hearing briefs. With respect to the dumping/subsidization issue, hearings do not play an important role in the ITA information-gathering and decision-making process, but the parties do have considerable opportunity to present their evidence and arguments to the ITA, through both informal ex parte contacts and the submission of written evidence and briefs.

The ITA and the ITC are not required to and do not operate pursuant to the Administrative Procedure Act (APA).[161] They do not use administrative law judges (ALJs) and do not hold APA-style hearings in which the basic evidence to be considered is presented to the decisionmaker and witnesses are subject to cross examination.[162] It appears that the absence of such hearings means that the contending parties cannot contest the arguments of their opponents as well as they might if there were such hearings.

### *(i) ITA*

In the case of the ITA, a brief, perfunctory hearing is held at the end of the proceeding, presided over by a senior official--typically either a deputy assistant secretary or office director--the two levels in the hierarchy immediately below the Assistant Secretary for Import Administration. Although there are occasional exceptions, this official typically does not participate in the hearing, but rather simply listens without question or comment to the arguments presented by the parties. It appears from statements made by present and former ITA representatives, that this practice stems in large part from a desire to avoid saying anything that might later be cited as somehow committing the ITA to a specific position on some issue. Needless to say, this practice renders the typical hearing rather useless, as there is no give and take between the hearing officer and attorneys. Issues that might be clarified are not because it is not known what is unclear in the minds of the ITA decisionmakers. This has the deleterious effect, according to at least one former administrator, of forcing the decisionmaker to rely too heavily on the views of the ITA staffers assigned to the case. The hearing could and should be, but is not now, a vehicle for getting nonstaff input on key issues.

It could be argued that there is adequate opportunity to present arguments to the ITA because parties (or more likely, their attorneys) can and do contact ITA officials on an ex parte basis at all levels to make arguments. While there are such opportunities, it would seem preferable for the opposing party to be present when such arguments are presented and also to have an occasion designed for interchange between the decision-making agency official and the parties. Thus, we conclude that the quality of decisions would likely be better with improved hearing procedures.

As an aside, it is instructive to compare the ITA hearings, where there are often no questions asked, with hearings before binational panels considering appeals of U.S.-Canadian AD/CVD cases under Chapter 19 of the U.S.-Canada Free Trade Agreement. These hearings, which typically involve a fair amount of give and take between the panelists and counsel for the parties were cited to us as being far more useful than the ITA's current hearings--precisely because of the greater interchange of views between the attorneys and the panelists who make the decision.

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[161] 5 U.S.C. §§551-559.

[162] The "central model" under the APA for adjudication on the record is the use of ALJs and formal evidentiary hearings. See P. Strauss, An Introduction to Administrative Justice in the United States 144 (1989).

### *(ii) ITC*

The ITC does hold a hearing at which there is interchange between counsel for the parties and the ITC commissioners. Dissatisfaction was expressed to us, however, about the usefulness of this hearing as well. While parties can present testimony, the ITC rules discourage cross-examination by deducting time so spent from the time allowed for affirmative presentation. Moreover, the ITC tends to hold standardized, relatively brief hearings regardless of the complexity of issues and numbers of parties involved in the proceeding, which means that it cannot always delve into the issues in any depth.

The extent of dissatisfaction with the ITC hearing process varied considerably. Some practitioners felt that they had adequate time to present their cases; others thought that in complex cases with multiple parties there was not enough time. Members of the ITC Chairman's staff expressed the view that there was not enough testing of evidence in the hearings:[163]

> In a typical investigation, there is little or no opportunity for the Commissioners--who are only finders of fact--to observe, question, or interact with the parties who provide a major portion of the information on which a decision is based. At no point do the parties have a clear opportunity to question or cross-examine those who provide the information in a meaningful way.

Thus, we would conclude that improvements could be made to the ITC hearing process as well.

### *(iii) Summary*

It appears that the 1979 amendments to the AD/CVD laws made proceedings under those laws much more adjudicative. This can be seen in part by the requirement that the ITA and the ITC hold non-APA hearings before decision in such proceedings. From the foregoing, it appears that the hearings now held are not as effective as they could be. We consider below two ways that they could be improved: (i) the use of ALJs and APA procedures and (ii) changes in the current hearing procedures.

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[163] Letter To Hon. M. Breger from R. Parker and R. Boorstein, Feb. 28, 1991.

### b. An impartial decisionmaker

The second component of procedural fairness is impartial decision-making. To evaluate this, it is useful to recall the structure of the decision-making process at the ITA and the ITC. At the ITA, decisions potentially affecting the outcome of investigations are made at varying levels--from case analysts to the Assistant Secretary of Commerce for Import Administration; at the ITC, some decisions are made by the staff, but the basic decision on whether or not there is material injury is made by the Commissioners.

Since the Assistant Secretary at the ITA and the Commissioners at the ITC are presidential appointees, confirmed by the Senate, some participants in AD/CVD cases are concerned that these individuals might tilt their decisions in favor of domestic industry because of their connection with the political process. Moreover, lower echelon employees might act to favor domestic interests on the belief that such favoritism would be noticed by their superiors and redound to the benefit of their careers over the long run.

In addition, there was some concern in comments made to us that the international trade bar is a very "clubby" group. One possible consequence of this is that certain lawyers may have better access to the higher levels of decision-making, particularly in the ITA, and thereby be better able to influence decisions on matters of interest to their clients or at least more effectively draw the attention of senior decisionmakers to those matters. Knowledge that senior officials were interested in a matter might affect the way a case is handled by the analyst and manager. Interestingly, while we believe that some lawyers probably have better access to higher officials than others, we heard little complaint about this practice from the bar itself. (Officials at the ITC suggested that the Commissioners were relatively insulated from informal contacts.)

We found no specific evidence of bias on the part of ITA or ITC officials. We did find, however, that there is a perception on the part of some (mainly, but not exclusively, foreign respondents) that ITA decisions are sometimes influenced by political factors.

For example, the belief that politically motivated decisions are made was a major factor in causing Canada to push for the inclusion of the binational panel review process for AD and CVD cases in the U.S.-Canada Free Trade

Agreement. In early 1987, Canada's International Trade Minister Pat Carney was quoted as follows:[164]

> We want impartial mechanisms. For example, if the U.S. alleges that our stumpage programs are subsidies, we want an impartial, binational tribunal to deal with the issue, not the U.S. Department of Commerce.

In a recent AD investigation of Japanese-origin flat panel display screens, the Journal of Commerce reported:[165]

> The investigation has become so politically charged that some, including House Majority Leader Richard Gephardt, D-Mo., are worried the outcome is already "fixed" and could have nothing to do with the department's actual findings. Examples such as these raise the question of whether the current system is viewed as sufficiently impartial and whether it could be improved in that regard. Accordingly, we consider below how an arguably more neutral decisionmaker could be inserted into the administrative process.

### c. A right of appeal

The decisions of the ITA and the ITC are appealable to the Court of International Trade and thereafter to the Court of Appeals for the Federal Circuit. In practice, there has been extensive judicial review of administrative action in AD and CVD cases, particularly when compared to the other major users of AD laws. Thus, the existence of appellate review is not an issue. If anything, as we discuss below, the issue is whether there is so much time spent in court proceedings that the overall procedures have become too time-consuming and expensive.[166]

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[164] 4 BNA Intl. Trade Rptr. 369 (1987). See also Vicario, *The Anatomy of Antidumping Proceedings: A Case Study of the Antifriction Bearings Investigations*, 15 N. Car. J. Intl. L. & Comm. Reg. 249, 265 (1990) ("The [ITA's] position on standing [in the antifriction bearings case] only reinforces the opinion held by many that the administration of the antidumping law is politically sensitive with domestic industries and their congressional supporters.").

[165] Journal of Commerce, July 5, 1991, at 1A.

[166] See Sections II.A.4. at page supra and III.D. at page infra.

**Summary**

Generally, we found the U.S. system to be fair in the sense that the most interested parties were able to make relevant arguments to the administrative authority and that those parties (or their attorneys) were well informed as to the contentions and evidence of the opposing parties. The hearings held before the ITA and the ITC seemed inadequate, however.

We found no hard evidence of a politically related bias against foreign interests in the ITA or ITC. Nonetheless, there is a perception, particularly among some of those who represent foreign interests, that the agencies tend to favor domestic interests. This perception may be unavoidable given that the laws are administered by the government and that the affected domestic interests have better access to the political process than do the foreign interests.

Given our conclusions, it is appropriate to consider if changes in the procedures used in AD and CVD cases could be made so as to reduce the possibility and perception of bias and to improve the hearing process. Two solutions seem worthy of consideration: first, use of ALJs in AD/CVD investigations; second, other revisions to the current hearing procedures.

## 4. Use of ALJs and APA Procedures

One possible model for AD/CVD proceedings would be one based on the APA.[167] In adjudicative proceedings under the APA, the government's case is introduced at an evidentiary hearing before an ALJ, at which witnesses appear and are subject to cross-examination. The respondent is allowed to put on its defense, as well. In essence, the matter proceeds like a trial before a court. The ruling of the ALJ is typically appealable to a higher authority within the agency, such as the Secretary or Commission.

Such a procedure is not unheard of in unfair trade cases. Under section 337 of the Tariff Act of 1930,[168] claims by a U.S. industry that it has been injured by unfair methods of competition or unfair acts in the importation of goods (including by patent or trademark infringement) are adjudicated by ALJs employed by the ITC in accordance with the APA.[169] These cases are processed in accordance with strict time limits--usually the final determination of the ITC, which may review the ALJ's decision, occurs within 1 year, although complicated cases may take 18 months. The proceedings before the ALJ resemble court proceedings--there are provisions for discovery, for presentation of evidence and witnesses and for cross-examination.

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[167] 5 U.S.C. §§551-559. See note 162 supra and accompanying text.

[168] 19 U.S.C. §1337.

[169] See generally D. Duvall, Federal Unfair Competition Actions: Practice and Procedure Under Section 337 of the Tariff Act of 1930 (Clark Boardman, 1990).

Three basic questions are presented by a proposal to use ALJs in AD/CVD cases. First, how would they be inserted into the process? Second, would their use solve the problems highlighted above? Third, would their introduction raise other problems that would offset any benefits obtained from their use?

### a. The role of the ALJ

When and how could an ALJ and APA procedures be inserted into the process and what effect would that have on the cost and length of the proceedings? We do not think that the insertion of an ALJ in the process should change the role of the petitioner or respondent in an AD/CVD investigation. The issue to be considered is to what extent tasks now performed by the ITA or ITC staff would be reassigned to the ALJ or his/her staff. We first consider the use of an ALJ in ITA proceedings; then at the ITC.

#### *(i) ALJs at the ITA*

Essentially there are two points in AD/CVD proceedings in the ITA at which ALJs could be inserted: at the very beginning of the case or following the ITA's preliminary determination. In the former case, the ALJ would be involved in all aspects of an AD/CVD investigation; in the latter case, the ALJ would essentially decide on challenges to the ITA's preliminary determination and its proposed final action.

**ALJs at all stages.** If an ALJ were to be inserted in the process at the very beginning of a case, presumably the ALJ would decide whether the petition was sufficient to open an investigation.[170] The principal effect of this change would be that the petitioner would lose some ability to consult with the decisionmaker concerning whether a prospective petition was sufficient, but that change would presumably not be too great, since the petition could be refiled to meet whatever objections, if any, the ALJ had.

The more difficult issue concerns how the investigation would be conducted. If an ALJ has already been assigned to a case, should it be involved in resolving disputes between the ITA and the parties? For example, soon after opening an investigation, the ITA distributes questionnaires to and collects responses from the exporters and others. What role would the ALJ have in this process? Would the ALJ review the ITA's determinations with respect to the coverage of the questionnaires or the scope of the investigation?

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[170] In section 337 cases, the decision to open an investigation is made by the ITC on recommendation of its staff. Once opened, an investigation is assigned to an ALJ.

How thorough would that review be? Would the ALJ be involved in reviewing the questionnaire responses? If the ALJ's review was more than cursory in any of these cases, the ALJ would probably need the assistance of a considerable staff. The cost of such a change would as a consequence be an issue. More significantly, however, would be the question of timing. The ITA is now hard pressed in many cases to meet statutory deadlines. Adding a layer of preliminary review would necessarily add to the time necessary to process cases. Since the effect of the ITA's preliminary decision on dumping/subsidization is only temporary, one could ask whether such additional cost in time and money would be justifiable.

While an affirmative preliminary determination of dumping/subsidization has a trade disruption effect beyond that caused by the filing of a petition, its effect is temporary, as the final determination is normally made within 135 days.[171] Consequently, it would probably not be of great importance to have ALJ participation prior to the preliminary ITA determination. This consideration, in conjunction with the somewhat unclear role that an ALJ would play in the preliminary stages of an investigation and the additional time such a role would entail, suggests that use of an ALJ from the very outset of the case would not be appropriate.

**ALJs after the preliminary determination**. Use of an ALJ after the preliminary AD/CVD determination has been made could be more advantageous.[172] The ALJ could decide on the issues raised by the parties with respect to the preliminary determination.[173] The role of the parties would not change. They now comment on the ITA's determination; with an ALJ, they would address those comments to the ALJ. The role of the ITA would clearly be modified. At present, after the preliminary determination, the ITA conducts verification of the responses it has received and decides how to change its initial determination in light of verification and the comments of the parties. The ITA would continue to conduct verification.[174] This would seem to be practical in that the ITA could then report on its verification findings to the ALJ and the parties. Thereafter, following receipt of the parties' comments on the preliminary determination and verification, the ITA could issue a proposed decision and respond to those comments as a representative of the public interest to justify its proposed action. The ALJ would then affirm or order the modification of the ALJ's proposal, following briefing and hearing. Because the prime information-gathering responsibility would remain with the ITA, it would seem unnecessary to give discovery rights to the parties.[175]

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[171] Tariff Act of 1930, §§705(a), 735(a); 19 U.S.C. §§1671d(a), 1673d(a).

[172] In the case of annual reviews, the ALJ's involvement would commence after the ITA had reached its preliminary results, which usually occurs after verification, if any.

[173] It would also be possible for an ALJ to make certain discrete decisions that need to be made early in an investigation, such as reviewing a preliminary negative ITA determination, determining scope issues or deciding whether a cost of production investigation is justified.

[174] Putting the responsibility for verification on the ALJ would probably not be workable because it would require the existence of a substantial staff. While verification could be made the responsibility of the parties, that would (i) put a heavy additional burden on the petitioner and (ii) would probably be viewed as undesirable by the respondent since the involvement of a petitioner's representative in the verification process would entail revealing information that now is not revealed to petitioner because it is not collected by the ITA.

The use of ALJs as described in the foregoing paragraphs is analogous to their use in other contexts. For example, the staff of the Federal Trade Commission may initiate an investigation on the complaint of a private party. The staff then "prosecutes" the case before an ALJ. While the original complaining private party may continue to supply information to the staff, the staff is primarily responsible for pushing the case forward. The respondent's position is not unlike that of the exporter in an AD/CVD proceeding. A second example would be the National Labor Relations Board, where the staff investigates and prosecutes private complaints before an ALJ. Thus, the use of ALJs in the manner proposed in AD/CVD cases would not be without precedent.

Compared to the present system, the use of ALJs in this manner would make two basic changes. First, the major arguments of the parties--their comments on the preliminary determination and proposed final determination--would be made to a more impartial decisionmaker. The principal advantage would be increased impartiality resulting from changing the identity of the decisionmaker; the downside would be the likelihood that additional time would be required for the ALJ to hear argument and make his or her decision. Considerable time could be saved, however, if this change were combined with the elimination of CIT review, a proposal discussed below.[176]

Second, since the ALJ would hear arguments at a hearing, there would be a more thorough ventilation of the disputed issues by the parties and the ITA. The nature of that hearing would have to be determined, but it would seem appropriate to allow for the calling and cross examination of witnesses, although we do not envision witness testimony at hearings as being a significant source of information for the ALJ.

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[175] Section 337 cases, where the parties have basic discovery rights, are much more similar to private litigation in courts than are AD and CVD investigations. As noted at the outset of this discussion it would be preferable to continue to place the information-gathering role in such investigations on the government. The lack of discovery rights would not be unique; the NLRB does not permit discovery.

[176] See subsection c.iii. at page infra for a discussion of how much more time would be required.

### *(ii) ALJs at the ITC*

At the ITC, the ALJ could preside over either or both of the preliminary phase and final phase of the ITC's injury investigation. In the case of the preliminary determination, we would propose that the ALJ take the ITC's current role with the rest of the proceeding remaining the same--the ALJ would make his or her decision on the basis of a staff report.

As to the final determination, we would envision the ITC staff continuing its current role of information gathering. (Among other consequences, this would solve concerns expressed by the ITC staff as to whether the right mix of information would be obtained in an ALJ proceeding.) As part of the final determination process, the ALJ would preside over a formal hearing at which there would be presentation of evidence and cross-examination of witnesses. This would be a significantly expanded version of the hearing now held before the ITC, perhaps more in the nature of the injury hearing before the Canadian International Trade Tribunal.

An expanded hearing before an ALJ would solve the shortcomings of the ITC hearing process described above by providing for more thorough hearings with more rigorous testing of the parties' arguments and evidence. While the ITC commissioners could in theory conduct such a hearing, we believe that given their workload, it would not be practical for them to do so. An APA-style hearing would take more time than under current procedures, where hearings take at most 1 day.[177]

### b. The advantages of using ALJs

It appears to us that the use of ALJs would solve the problems of inadequate hearings and perceptions of partiality discussed above. Under an ALJ system, initial agency decisions concerning the applicability of agency rules would be made by a neutral decisionmaker who presides over a hearing at which the relevant facts are presented and tested by cross-examination. Such a hearing would go into more detail and allow better testing of the evidence and arguments of the parties than do the hearings under the present system.

Moreover, use of an ALJ would mean that those persons in the agency who are charged with investigating AD/CVD matters would not be the same ones who decide the issues raised by the investigation, as is now the case at the ITA. Accordingly, the use of ALJs in AD/CVD cases would likely reduce, and perhaps even eliminate, perceptions of partiality. Although ALJs are formally employed by the agency in which they serve, the APA contains mechanisms to ensure their independence and insulation from political pressures.[178] Moreover, virtually all contacts with the ALJ would be in the presence of all counsel, thus mitigating the "differential access" problem to the extent that it exists. Consequently, better and more impartial decision-making should result.

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[177] See subsection c.iii. at page infra for a discussion of how much more time would be required.

### c. Possible disadvantages of using ALJs

A number of issues must be considered to decide whether the benefits of using an ALJ system would be outweighed by disadvantages. First, are ALJ hearings suitable for the type of issues raised in AD/CVD proceedings? Second, what effect would the use of ALJs and APA procedures have on agency decision-making? Third, what effect would they have on the length and cost of AD/CVD proceedings? To the extent that they would lengthen the proceedings, could other parts be cut? Fourth, how "final" would an ALJ's decisions be (i.e., would they be "appealable" to higher agency authorities)? What effect would a lack of finality have on the impartiality issue?

#### *(i) Appropriateness of AD/CVD issues for ALJs*

It appears to us that the issues in an AD/CVD proceeding are the sort of issues that are appropriately considered in a trial-type hearing by an ALJ. Essentially an AD/CVD proceeding involves establishing historical facts and applying rules to them. There are two (or more) parties that are offering competing versions of the facts or of how agreed-upon facts should be treated in light of the relevant rules. An ALJ would resolve factual disputes and apply a defined body of rules and precedents to the facts as determined. As such, AD/CVD proceedings are appropriate for trial-type hearings of the sort that ALJs were intended to hold.[179] Thus, an ALJ would be well-suited to listen to and resolve such disputes between the parties and the government.

It is true, of course, that in AD/CVD proceedings there is considerable dispute over what significance accepted facts have. For example, much of the parties' argument before the ITC may be that given facts do or do not constitute material injury. We think that an ALJ would be well suited to hear and decide such arguments.

#### *(ii) Effect on agency decision-making*

Some commentators have expressed concern that the use of ALJs at the ITC would have an undesirable impact on ITC decision-making. These concerns seem to be twofold. First, there is a worry that the ITC will not obtain the information it needs to make its decision because the parties will not or cannot provide it with the necessary information. For example, the ITC obtains information from customers of the domestic industry about conditions in the marketplace. That information would probably not be obtainable by either the petitioners or respondents.

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[178] See U.S. Office of Personnel Management, Office of Administrative Law Judges, *Administrative Law Judge Program Handbook* 1-2 (1989).

[179] See Cramton, supra note 149, at 588.

We think that this concern is misplaced. It would apply if the primary responsibility for information gathering were placed on the parties, but that is not the proposal. The ITC staff would continue to gather the information that it currently collects. Its role before the ALJ would be that of an information resource. There is no reason for the staff's role to change significantly.

Second, some commentators expressed concern over whether the staff would collect and the ALJ would include in the record all the information the individual commissioners consider important in making their decision. As background, it should be noted that the approach of individual commissioners to the injury question has varied widely, and different information is considered important by different commissioners. We do not believe that this would be a problem, however. ALJs are often used in proceedings that ultimately are reviewed by multiperson commissions, and they will certainly learn quickly what information their reviewing body wants in the ALJ decision.[180]

A more general criticism of the effect of ALJs on ITA/ITC decision-making is that their use would convert the staffs of both agencies from independent, impartial factfinders into advocates of one position or another. We would question at the outset whether there would really be that much of a change in this regard. At present, the parties attack staff conclusions and try to convince their superiors to change them and the staff defends its actions. Under a system using ALJs, the same process will occur, except that the decisionmaker will be the ALJ instead of the Commission or a higher ITA official. Consequently, we do not believe that the use of ALJs would have a serious deleterious effect on the role of the staff in AD/CVD investigations at either the ITA or the ITC.

Finally, it has been argued that the use of ALJs would lead to a less coherent body of rules in AD/CVD matters because the various ALJs would each have his or her own individualistic interpretation of the AD/CVD law.

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[180] In the early 1980s, the ITC experimented with having its Director of Operations make a recommended decision in preliminary determinations. Apparently the first few such recommendations were rejected and the experiment was ended. While we can see that a new procedure for an agency might be unpopular with those used to a different way of doing things, we do not see any inherent reason why decision-making at the ITC cannot be done effectively under procedures commonly used in other agencies.

This assumes that the ALJs would ignore each others' decisions and that agency and court review would not standardize practices, an assumption that we do not share.

Thus, we conclude that use of ALJs would not adversely affect ITA/ITC decision-making. Indeed, for the reasons discussed above, we believe that the use of ALJs would improve agency decision-making.

*(iii) How much additional time?*

The use of ALJs would clearly lead to a lengthening of AD/CVD proceedings. Assuming the ALJs would be involved only at the ITA after the preliminary determination, this lengthening would not affect the point of time at which preliminary relief is now available. The ITA could issue its proposed final determination no later than at present, perhaps even a bit earlier. It is clear that requiring the ITA to defend its determinations before the ALJ would necessitate additional time, compared to the present system, for brief filing, argument, and decision by the ALJ, plus additional time in some cases to implement the ALJ's decision. It seems feasible to us for the parties to file briefs on the ITA's position, the ITA to respond, a hearing to be held, and a decision rendered within 2 months.[181] Since decisions of ALJs are typically appealable to a high-level authority within the relevant agency, an additional month or so would be needed for that review, with additional time required for those cases where the ITA had to implement changes required as a result of that review.

More time would also be needed for the ITC's injury investigation. Now, hearings of 1 day or less are the norm. In contrast, the formal hearings of the Canadian International Trade Tribunal, which include presentation of evidence and witnesses by the parties, subject to cross examination, typically last 3 or 4 days, according to Canadian officials, but have taken as long as 2 weeks. Somewhat longer hearings would not significantly expand the time needed in

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[181] The schedule could be as follows:

Day 1: ITA Proposed Decision
Day 21: Briefs of Parties
Day 35: ITA Brief
Day 35+: Hearing
Day 60: ALJ Decision

To the extent that the ITA has not radically changed its preliminary determination, the ITA brief would be in the nature of a reply brief. This would be true particularly in the case of administrative reviews.

ITC proceedings and the ALJ could probably issue his or her decision about as promptly as the Commission does now. More time would be needed, however, for Commission review of the ALJ decision. Under section 337 procedures, the ITC must decide within 45 days whether to review an ALJ decision and whether to hear further argument.[182] If further argument is ordered, the ITC may limit the issues it will consider. Consequently, inserting an ALJ into the ITC injury determination would probably require some additional time (perhaps a month or two) to be added to the time frame of the standard injury investigation.[183]

It seems reasonable to conclude that the final dumping/subsidy decision could not be implemented until 2 to 3 months later than the current time for the ITA final determination, assuming no agency review of the ALJ decision occurred.[184] If the ITC's final determination were also made in this time period, which would be feasible, then the net addition to an AD/CVD proceeding would be 30 to 45 days. There would be two complications. First, more time would be needed if Commerce Department authorities reviewed an ALJ decision. Second, the ITC could not act until the final dumping margins were established, but it could do so immediately after those numbers were known, and it seems to us that its injury investigation could proceed on the basis of the ITA's proposed decision.

Thus, it appears that the use of ALJs at both the ITA and the ITC would add 1 to 2 months to the length of an investigation. However, there is one other change discussed below that would be more feasible if ALJs were used as described above and that could result in considerable time savings. That change is the bypassing of the CIT to which most ITA and ITC decisions are appealed.[185] Judicial review would then be in the Court of Appeals for the Federal Circuit, to which CIT decisions are now appealable.[186] This arrangement would be more typical than the present one, as federal administrative agency actions are usually reviewed in the federal courts of appeal, not in trial level courts. It would also be in accord with the Administrative Conference's general recommendation on appellate review of administrative action.[187] In the case of AD/CVD cases, such a procedure might not be appropriate now, but with the insertion of an ALJ (i.e., an impartial, judicial-like decisionmaker at the agency level), there would be much less reason for two levels of court appeals of right.

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[182] 19 CFR §210.54. One commissioner has the power to cause the entire Commission to review an ALJ decision.

[183] Use of ALJs only at the ITC would add relatively little time to the length of an investigation.

[184] In the case of administrative reviews, there are no real deadlines currently enforced. This proposal would not be inconsistent with a system of administrative reviews that was more timely than the current system.

[185] See Section III.D. at page infra.

[186] The Federal Circuit now hears appeals from a wide variety of federal bodies, such as the CIT, the Claims Court, the Board of Contract Appeals, the Merit System Protection Board, certain ITC decisions and certain administrative proceedings involving patents, as well as appeals from patent, trademark, and copyright decisions by the federal district courts.

If CIT review were eliminated, the 1 or 2 additional months added to the final stage of the investigation by using ALJs could probably be recouped several times over since, as noted above,[188] most cases are appealed to the CIT and review in the CIT is very time consuming. This would mean that final decisions on duties owing could be expected much sooner. Thus, if CIT review were eliminated the result in a typical case would be "final" months, if not years, sooner than at present. Since the CIT's budget in the proposed 1992 Budget was listed at $8.8 million, and its workload would be cut in half if AD/CVD cases were taken from its jurisdiction, there would a source to fund much of the increased cost to the government of using ALJs, which is discussed in the next section.

### *(iv) The additional costs of using ALJs*

Use of ALJs would also cost more money, both for the parties and the government. For the parties, we do not think that the difference would be that substantial since they would be making the same arguments as they now make, with the exception of briefing and arguing the case before the ALJ and possibly appealing the ALJ decision to the Commission or Assistant Secretary. Moreover, the costs of CIT review would be eliminated.

For the government, the installation of ALJs would clearly increase the cost of processing these cases and there would be no decrease in current spending if the staffs play the role that we envision for them. How much ALJs would cost is difficult to estimate. One estimate is that it would cost $7.5 million, or 50 percent of the ITA's current budget for AD/CVD cases.[189] While this estimate is probably on the high side, use of ALJs would definitely result in higher costs. As noted above, however, a reduced CIT budget might be used as source of funds to cover much of this additional cost.

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[187] Conference Recommendation 75-3, "The Choice of Forum for Judicial Review of Administrative Action," 1 CFR §305.75-3 (1991).

[188] See Section II.A.4. at page supra.

[189] S. Powell, Chief Counsel for Import Administration, Dept. of Commerce, Speech, Federal Circuit Judicial Conference, May 9, 1991,

### *(v) Finality of ALJ decisions*

It is standard practice in administrative agencies that a decision of an ALJ is reviewable by a higher authority within the relevant agency. From comments made in discussions of this issue, it seems clear that such an opportunity for review would probably be necessary in AD/CVD cases. The existence of such review would raise a couple of serious questions.

First, it would mean that the political input that some people perceive to exist now in AD/CVD cases and that would otherwise be reduced or eliminated through the use of ALJs would reappear. Since it is precisely those controversial cases that would draw the attention of an agency reviewer, the possibility of such review could mean that there would be no improvement in perceptions as to the impartiality of the AD/CVD process. For example, in the *Canadian Softwoods Lumber* case, the issue of whether certain Canadian governmental practices constituted countervailable subsidies is the kind of policy issue that would be ripe for review at the highest agency level, after an ALJ decision. Such a result could inject a political aspect to these matters, something which the use of ALJs was supposed to avoid in the first place. We tend to think that the number of issues that would justify intervention on policy grounds would not be that great, but opponents of the proposal suggest that such policy review would be intrusive.[190]

Second, the existence of such a review proceeding could significantly increase the time and cost of inserting ALJs if it were to be used as a matter of course in most cases. We would anticipate such review to be pro forma in most cases. However, the existence of a specific procedure for review at a high level might cause the parties to focus more attention on that review and to treat it as an appeal of right.

Thus, the need for agency oversight would negate some of the benefits of using ALJs. The improvements in the hearing process would not be affected, but it is less clear that there would be much improvement in the perceptions of partiality that now exist.

### d. Evaluation of using ALJs

The use of ALJs would improve the hearing process at the ITC and ITA. It would also solve some of the other problems parties now encounter in dealing with the ITA, such as surprise changes in methodology, and offer the potential of solving other problems, such as inconsistencies in ITA practices.[191] It would likely reduce perceptions of bias or differential treatment at the hearing stage,[192] because ALJs, like federal judges, are insulated from informal contacts by parties or their attorneys and from political pressures while the current decisionmakers in the ITA are not. This gain would be offset to the extent that the agency frequently revised ALJ decisions on review. Finally, it is arguable that the ALJs over time would render better initial decisions, which might in the long run reduce the number of appeals.

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[190] See, e.g., S. Powell, supra note 189.

[191] See Section III.B. at page infra.

On the other hand, the use of ALJs would entail costs in terms of more money and time being devoted to the administrative process. Some of the money would be saved in eliminating CIT review, and the parties would probably have the final answer to the amount of duties owing, if any, sooner than they do under the present system. The increase in time could mean that proceedings in more cases than at present would exceed 1 year before an AD/CVD order is issued.[193] The insertion of ALJs would, however, be a major structural change in the system and it would take some years for that change to be digested.

We believe that the benefits of the use of ALJs to the parties outweigh the costs to the parties, once the system is operational. As to the government, the increased costs of ALJs to the agencies would be largely offset by cost savings obtained from greatly narrowing the jurisdiction of the CIT.

## 5. Changes in Current Hearing Process

Instead of adopting a system using ALJs, it would be possible to eliminate some of the problems with hearings at the ITA and ITC with more minor changes in the hearing procedures. As we noted above, the two agencies view AD/CVD proceedings as investigative rather than adjudicatory. Nonetheless, given the conflicting positions of the parties before the agencies--the domestic industry versus the foreign exporters--and their role in supplying much of the information on which the agency decisions are based, the parties do and should play an important part in the process and that part could be made more useful if hearings at which the submissions of the two sides are tested could be conducted more effectively than at present.

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[192] It is possible that over time ALJs would be "captured" by the agency and start to identify with it and take its side in most disputes. This, of course, would increase perceptions of bias if it occurred. We doubt that it would, any more than it has to date with respect to the Court of International Trade (CIT) and the Federal Circuit. These courts are specialized courts (especially the CIT) and the same arguments--familiarity with the agency and tendency to side with it--could be made vis à vis the current system. It is not our impression, however, that the CIT has been too deferential to the ITA and ITC, see GAO Report, note 95 supra, at 40, even if its impact on agency interpretation of the AD/CVD laws has not been that great.

[193] Under the GATT Codes AD and CVD investigations are normally supposed to be completed within 1 year. Antidumping Code, supra note 11, art. 5(5); Subsidies Code, supra note 12, art. 2(14). Under U.S. laws dumping investigations in which there are no time extensions now take about 9 months; subsidies investigations take about 7 months. Complicated investigations may even now extend beyond 1 year. See Section II.A.1. at page supra.

In the case of the ITA, the hearing is now typically conducted by a deputy assistant secretary or office director--the two levels in the administrative hierarchy immediately below the Assistant Secretary for Import Administration--and the hearing officer now typically does not participate in the hearing or engage in interchanges with counsel. The ITA hearing process would be improved if the hearing officer were more knowledgeable about the contested issues and participated more actively in interchanges with counsel than is currently the case. In the view of one counsel who has been active representing petitioners, the need is to have someone the parties can talk to, even if that person is not neutral.

In the case of the ITC, standard hearing times for cases are typical even though cases vary widely in complexity and number of parties, with the result that in some cases parties have only a few minutes to present their arguments. Testing of factual information is limited by rules that discourage cross-examination of witnesses. The ITC hearing process would be improved if, in setting the times for argument, the ITC took into account factors such as the complexity of the case and the number of parties involved. The ITC should also allow reasonable time for cross-examination without taking such time from the questioner's time for affirmative presentation.

## B. Cost Savings Measures

There are a number of changes in ITA procedures that would reduce the costs of the parties in AD/CVD cases or otherwise improve the process by which the parties and the ITA interact.[194]

First, faster preparation of the administrative record by the ITA would speed up the appeals of cases. We heard a number of complaints in this regard and there seemed to be no structural reason that the ITA could not do this.

Second, the ITA should streamline and standardize its procedures for handling routine protective order disclosure requests so as to reduce the amount of time spent by the parties in preparing such requests, thereby reducing costs. The ITA seemed to agree that its procedures could be improved and that they were now more cumbersome than those used at the

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[194] We did not study these proposed improvements in our preliminary report. They are based on comments made on that report and at the meetings of the Committee on Regulation. While less farreaching than the tentative recommendations for improving efficiency discussed in the preliminary report, we believe these proposals to be meritorious.

ITC. The ITA should also strive to reduce parties' costs by reducing where at all possible the number of copies of documents required to be filed.

Third, the ITA now sometimes decides to reject a party's factual submissions or to change its methodology for calculating dumping/subsidy margins without notice to the parties. It would be desirable for the ITA (a) to notify parties before it rejects their evidentiary submissions in favor of using "best information available" and (b) to give the parties the opportunity to comment on changes in methodology. Implementation of this recommendation would allow parties to argue their positions more effectively and avoid wasted effort. We do not intend to suggest by this proposal that a party have any new rights (i) to more time to comply with ITA information requests or (ii) to object to methodology changes.

Originally, the use of preliminary determinations was supposed to avoid this sort of problem by allowing the parties to comment on the ITA's position before the final determination. But in the initial investigation, because verification usually takes place after the preliminary determination, there may be considerable disparity between the preliminary and final, so much so that the use of comments on the ITA's preliminary determination is often unsatisfactory as a way to comment on the ITA's ultimate approach to a proceeding.

One way in which the foregoing could be accomplished, at least in part, would be for the ITA to issue a proposed final determination for a short comment period. Some practitioners with whom we spoke thought that this procedure would be a useful one, although others worried that it would be too consuming.

Fourth, at present there are a number of inconsistencies between the way that the ITA's investigations office (which handles the initial investigation to determine whether a AD/CVD order should be issued) and the ITA's compliance office (which reviews shipments made after the issuance of an AD/CVD order to assess the amount of duties owing) handle certain issues. Since there is no justification for these inconsistencies, the ITA ought to eliminate them.

Fifth, under U.S. law the actual amount of AD/CV duties owed is usually determined after the fact. While exporters deposit an estimated duty when goods are imported into the United States, that amount may be adjusted upwards or downwards as a result of an annual review, if requested. (If not requested by anyone, the estimated duties are collected as the final duties.) The ITA has traditionally had a large backlog of annual reviews, although it has been reducing it in recent years. The delay in finally determining duties owed is unnecessarily disruptive to trade flows and unfair to the parties to the case. Accordingly, the ITA should attempt to eliminate its backlog of annual reviews.

## C. Structural Reform of the ITC

In the course of our study, several complaints were made about the structure of the ITC. One was the undesirability of having an even number of commissioners. While this does lead to tie votes, the relevant statutes deal with that eventuality and we do not think that it poses a serious problem.

Second, there were concerns expressed about the background of the commissioners. It was felt by some that fewer former Congressional aides and more lawyers should be appointed. Since the quality of the Commission's work is determined by the quality of the individual commissioners, we do not think that any ironclad rules about nominees' backgrounds would be useful. While the decisions of the ITC are subject to appeal, many of the issues that it deals with, including the basic injury issue, are much more economic than legal in nature. Moreover, all of the commissioners have law clerks and are supported by the lawyers in the ITC's General Counsel's office. We accordingly saw no real need for legislative action on these concerns.

Third, there were complaints about the tendency of the commissioners to write separate opinions, thus making it difficult to know the exact basis of the ITC's determination.[195] While such a practice can make judicial review difficult if the reviewing court believes that some of the commissioners are using the correct standards while others are not, the problem can be solved by remand. While it seemed to us that this problem was potentially the most serious of those discussed in this section, we did not find it to be of major concern to most participants in the system. It does seem to us, however, that the ITC ought to strive to reduce the number of separate opinions and to attempt to agree on common positions.

Finally, it was called to our attention that the commissioners of the ITC apparently do not normally meet as a group to discuss their views of a case before their formal deliberations, apparently because of concerns stemming from the Government in the Sunshine Act. In a recent case, the Acting Chairman of the ITC noted:[196]

> Of course, in light of the Commission's practice of voting the week before opinions are due and then not sharing opinions--not even the opinion drafted by the General Counsel for the plurality--before they are released, I do not have the benefit of my colleagues' views on the central issues

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[195] See text accompanying note 47 supra.

[196] Coated Groundwood Paper from Austria, Etc., USITC Pub. 2359, at 56 n.7 (Feb. 1991)(views of Acting Chairman Brunsdale).

> in this case. I therefore do not know whether their arguments might have swayed me....

It appears that this practice adversely affects the ITC decision-making process. To encourage collegial decision-making, the ITC should take steps to exchange drafts, views and other information before entering into formal deliberations. If the Sunshine Act impedes it from doing so, the Act should be amended.

## D. Elimination of CIT Review

Agency action in AD/CVD cases can be appealed as a matter of right first to the Court of International Trade (CIT) and then to the Court of Appeals for the Federal Circuit. In examining the role of the CIT in this process, two facts stand out. First, the existence of two levels of court review of agency action is unusual. While models of judicial review of agency action vary, review only in the courts of appeals is much more common.[197] Second, review in the CIT of AD/CVD cases has been very time consuming. As we noted earlier,[198] most AD/CVD cases are appealed to the CIT and the typical appeal takes almost 2 years and often results in a remand for further agency action. Appeals from remands and to the Federal Circuit after all remands add additional time to the judicial review process. One could argue that in light of its cost in time and money and its unusual nature to begin with, CIT review should be eliminated.

There have, in fact, been proposals in the past to abolish the CIT altogether,[199] and the Senate version of the 1984 Trade and Tariff Act would have removed its jurisdiction in AD/CVD cases.[200] According to the fact sheet accompanying the Senate bill:[201]

> The only function of the courts in [AD/CVD] cases is to conduct an appellate review of the agency proceedings. Such review is more appropriate for a court of appeals than for a trial court. By eliminating the first step in this process, the

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[197] See Conference, Recommendation No. 75-3, "The Choice of Forum for Judicial Review of Administrative Action," 1 CFR §305.75-3.

[198] See Section II.A.4. at page supra.

[199] See Kennedy, *A Proposal to Abolish the U.S. Court of International Trade*, 4 DICKINSON J. INTL. LAW 13 (1985).

[200] Kennedy, supra note 199, at 23.

[201] 129 Cong. Rec. S10,757 (1983), quoted in Kennedy, supra note 199, at 23 n.80.

> bill brings the import relief area into conformity with the usual administrative practice and reduces the costs associated with appellate review by two different courts.

These reasons are essentially the same as those advanced by Professor Kennedy for eliminating the CIT's role in AD/CVD cases.[202]

While it is true that the current two tiers of appellate review are unusual, it is also true that the normal federal administrative agency procedures are not followed in the ITA or ITC in that no ALJ is involved. We think, as noted above,[203] that if an ALJ were inserted into the administrative process, the need for court review of AD/CVD cases would be much less since an impartial, judicial-like hearing would have already been conducted. In that case, elimination of CIT review would have the salutary side effect of solving the problem of the increase in time that might result from using ALJs, and considerable overall time and expense savings would result as well.

In the absence of using ALJs, it is less clear that restriction of CIT review of AD/CVD cases would be appropriate. The hallmark of the U.S. AD/CVD system is its overall fairness, which to a large degree exists because there is serious judicial review of administrative actions in AD/CVD cases. Indeed, a major complaint about other AD/CVD systems is their lack of effective judicial review. We would hesitate to give up the fairness associated with the U.S. system solely for minor efficiency gains.

Accordingly, the issue would seem to be whether review of AD/CVD cases only in the Federal Circuit would result in inadequate judicial review of AD/CVD cases. It is not obvious to us why it would. Moreover, if the only effect of the elimination of CIT review on the outcome of cases was somewhat less intrusive judicial intervention in the minute details of dumping/subsidy margin calculations, it is not clear that there would be any negative impact on the overall fairness of the U.S. system at all. As we have noted before, one justifiable criticism of the U.S. system is that too many resources are devoted to establishing a precise result from an inherently imprecise calculation system. It is probably true that the overall fairness of the U.S. system would, if anything, be enhanced if AD/CVD cases were resolved more quickly, which would probably be the result of the elimination of CIT review.

The only possible disadvantage would be if the Court of Appeals for the Federal Circuit was unable to monitor these cases adequately. Although, we see no reason why the Federal Circuit could not adequately handle appeals from ALJs in AD/CVD cases, although its workload might well increase, many practitioners feared that it would not.

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[202] Kennedy, supra note 199, at 20-23.

[203] See Section III.A.4. at page supra.

Thus, while the matter requires a more thorough study than we were able to undertake, we think that serious consideration should be given to eliminating CIT review in AD/CVD cases, even if an ALJ system is not established.[204]

If CIT jurisdiction of AD/CVD appeals is retained, we would note that there were a number of comments made to us on ways that CIT practices could be significantly improved. For example, the agencies and most of the lawyers active in these cases are based in Washington, DC It makes little sense to have the CIT in New York. Second, there is a feeling that the CIT is nine courts, not one, because each judge goes off by him or herself without always paying attention to the rulings of his or her colleagues. The expanded use of more three-judge panels to hear important issues would help to eliminate this problem. Third, given that a case cannot normally be appealed until all remands are over, expanded use should also be made of certified appeals to the Federal Circuit so that the authoritative view of that court can be more quickly ascertained on significant issues.[205]

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[204] It seems to us that even without the use of ALJs, there is a strong case that can be made for eliminating CIT review of ITC decisions. Given the discretionary nature of the ITC decision --an evaluation of economic data to determine whether or not material injury has occurred or is threatened, we believe that Federal Circuit review would be sufficient. It does make some sense, however, to have the same judicial review procedures for both ITA and ITC decisions.

[205] In addition, we would note that a number of suggestions were made with respect to improving various CIT procedures. While outside the scope of this study, a number of them seemed meritorious at first blush and merit serious consideration in the appropriate forum.

# INDEXED BIBLIOGRAPHY
## 1968-1991

# ADMINISTRATIVE CONFERENCE OF THE UNITED STATES: A BIBLIOGRAPHY

## 1968-1991[1]

The Administrative Conference of the United States was established by law in 1964 as a permanent, independent federal agency to study the efficiency and fairness of the administrative processes in the federal government, and to recommend improvements to the President, Congress, and federal agencies. The Conference consists of 101 members who are the government's top legal officers, leading academic authorities in the field of administrative law, and experts from private practice who are knowledgeable about governmental processes. The Council, which is the executive board, consists of the Chairman and 10 members appointed by the President. Except for a full-time Chairman who is appointed by the President and confirmed by the Senate, all Conference members serve part-time and without compensation.

Topics of inquiry are chosen by the Chairman from a list of projects approved for future research by the Council. Major themes currently under study include adjudication, alternative dispute resolution, financial services regulation, government ethics practices, health and safety program procedures, judicial review, regulatory responses to international competitiveness and rulemaking. In most cases, a specialist in a certain field of administrative law is hired as a consultant to perform the research needed to draft a report and proposed recommendations. The consultant works closely with Conference staff and committees in drafting proposed recommendations to be considered for adoption by the Assembly. Recommendations adopted by the Assembly may result in new legislation or direct action by agencies to improve regulations or administrative procedures.

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[1] Earlier bibliographies appeared at 30 Admin. L. Rev. 303 (1978), 33 Admin. L. Rev. 235 (1981), 36 Admin. L. Rev. 307 (1984) and 39 Admin L. Rev. 245 (1987).

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Reports which were published as law review articles or in other periodicals reflect the title as it appears in the applicable journal. When the text of a recommendation no longer appears in the annual compilation of the CFR, a Federal Register cite to the text is listed in the CFR.[3] The first 35 recommendations of the Conference were sequentially numbered 1 through 35. Thereafter, the recommendations were numbered by calendar year, then sequentially as adopted within that year, *e.g.*, 72-1 refers to the first recommendation adopted in 1972.

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[2] *Cited* as 1978 ACUS ____, 1979 ACUS ____, etc. Prior to 1978, reports and recommendations were published in Recommendations and Reports of the Administrative Conference of the United States (*cited* as 1 ACUS ____, 2 ACUS ____, etc.).

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Daniel L. Skoler
Theodore Sky
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Paul E. Williams
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Wendell L. Willkie
Michael Wyatt
Seth D. Zinman